OPERATIONS OF THE SECONDARY MARKET FOR SBA GUARANTEED LOANS

HEARING

BEFORE THE

SUBCOMMITTEE ON TAX, ACCESS TO EQUITY CAPITAL AND BUSINESS OPPORTUNITIES

OF THE

COMMITTEE ON SMALL BUSINESS HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

FIRST SESSION

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WEDNESDAY, SEPTEMBER 28, 1983

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TAX, ACCESS TO EQUITY
CAPITAL AND BUSINESS OPPORTUNITIES,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:40 a.m., in room 2359A, Rayburn House Office Building, Hon. Henry J. Nowak (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN NOWAK

Mr. NOWAK. The subcommittee will come to order, and I think we can begin. Other members will be coming in and out as the day progresses. I know that everybody has a tight schedule. I would like to keep our schedule running.

The other members have expressed interest in this, and we will provide a summary for all those who have not been able to attend today because of all the other business that is pending and changes in the schedule on the House floor.

Small business has traditionally been dependent on commercial bank credit to meet its financing needs. For example, a survey of bankers by the Interagency Task Force on Small Business Finance indicates that 72 percent of the money borrowed by smaller firms comes from commercial banks. The same survey points out that small and medium size banks provide the bulk of the dollar volume of bank loans to small business.

An important part of the process by which the banks meet the debt-capital needs of small business is the guaranteed loan program of the Small Business Administration. Authorized by section 7(a) of the Small Business Act of 1953, the program enables commercial lenders to make long-term loans to smaller firms that otherwise might not be available. Moreover, it has provided small business with over $12.4 billion in financing in just the past 5 years alone.

A viable secondary market for SBA guaranteed loans provide lenders with the opportunity of further leveraging the amount of debt capital available to small business in the marketplace. More specifically, it can be an effective way of bringing the private and public sectors together for the promotion of economic development and capital formation. In operation since 1972, the secondary market enables lenders to sell the guaranteed portion of an SBA

loan to an investor. This provides the lender with an increase in liquidity and, as a result, enables it to make further loans to the small business community.

Despite its potential, the secondary market for SBA's guaranteed loans is not widely utilized. It is estimated that less than 25 percent of 7(a) loans are currently sold through secondary market activities. Nevertheless, this process has enabled financial institutions to increase their lending activity to smaller firms by about $400 million in recent years.

The Small Business Administration and the Congress must do what they can to insure that the SBA secondary market program is strengthened and continues to be a viable component of the capital formation process. This can be accomplished through such actions as the implementation of better recordkeeping procedures and a clear delineation of objectives for the program.

I am very happy this morning to have the Administrator of the Small Business Administration, James Sanders, who has been with SBA since 1981. He was first appointed as an Associate Administrator for Management Assistance, and in March 1982, he became the Administrator. Prior to joining the SBA, Mr. Sanders was a California insurance executive with the firm of Sanders and Sullivan; he was cofounder of that firm in 1951.

He will be accompanied here by Edwin T. Holloway, the Associate Administrator for Finance and Investment; and James B. Ramsey, Jr., the SBA Director of Secondary Markets in New York City. Mr. Ramsey, I understand, has been SBA Director of the Secondary Market Program since 1976, and he is the SBA's representative to the New York City financial community.

We want to welcome you, Mr. Sanders. If you would like to begin your testimony, your complete statement will be printed, so please excerpt parts or summarize, as you so desire.

[Mr. Sanders' prepared statement with attachments follow:]

PREPARED STATEMENT OF JAMES C. SANDERS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION

It is a pleasure to be here this morning to discuss SBA's Secondary Market. Appearing with me are Edwin T. Holloway, Associate Administrator for Finance and Investment, and James B. Ramsey, director of our secondary market activities. The secondary market is one of SBA's important tools in assisting small business. It is also one of our least understood programs, so I welcome the opportunity to discuss it with you.

WHAT IS THE SECONDARY MARKET?

The first question that naturally comes to mind is, "What is the secondary market?" In concept it is simple. It is designed to permit participating lenders to sell the SBA guaranteed portion of a loan to an investor. Essentially, a participating lender makes a loan to a small business and obtains SBA's guaranty. The lenders that elect to sell the guaranteed portion seek a buyer, normally through a broker dealer. An agreement is executed by the lender, the buyer and SBA after the loan is properly closed and fully disbursed. This agreement extends SBA's guaranty from the lender to a subsequent good-faith purchaser.

Although some lenders have set up their own marketing operation, most lenders sell the guaranteed portion to or through a broker. Typically brokers or others bid on the guaranteed portion, and the lender accepts the best available bid. The broker then may convert the guaranty portion through the use of the SBA appointed fiscal and transfer agent, into a certificate. This certificate, in turn, permits resale to a new buyer, who is generally a pension fund or other institutional account. As an

alternative to using the SBA-appointed fiscal and transfer agent, many secondary market sales occur by direct placement.

WHAT ARE THE BENEFITS

The principal benefit accrues to small business borrowers by virtue of the increased availability of lendable funds through local lenders. This is made possible by providing funds directly from sources that would not otherwise be accessible for investment in small businesses.

The funds available for the financing of small concerns come from a broader base and, therefore, the supply of funds is less likely to be interrupted by cyclical fluctuations in the financial markets. Competition is made possible in the origination and servicing of small business loans without large commitments of capital from the lenders.

As competition develops and improves, the terms of financing should become more favorable to the small business community.

Lenders have greater financial flexibility as a result of the liquidity provided by the secondary market. Therefore, their ability to continue providing financing to small concerns is enhanced.

Lenders can substantially broaden their customer base with moderate capital commitments and therefore realize operating and financial leverage leading toward improved profits from small business financing. This is the most positive incentive for participation in SBA lending.

These benefits to small businesses have been well summarized in a recent GAO report, which states:

"Sales of SBA-guaranteed loans in the secondary market benefit small businesses. Lenders are able to obtain funds from investors such as insurance companies, pension funds, and money market funds which traditionally do not invest directly in small businesses. For some small banks being able to gain access to these pools of managed capital is the difference between being able or unable to make an SBA-guaranteed loan. The secondary market process also has a leveraging effect, allowing lenders to reinvest the proceeds from sales in other small businesses. Lastly, the secondary market is used by some lenders to offer borrowers (1) the stability of fixed rate instead of variable rate loans and (2) lower interest rates."

Improvements in program operation

Although we believe the secondary market is generally sound, as with any complicated program there are improvements that could be made. Accordingly we are engaged in an ongoing effort to monitor and improve the program.

Some of the more significant problems include the following:

(1) The network for the operation of the secondary market may increase the fixed costs of financing in some cases.

(2) SBA has the problem of trying to regulate the maximum rate charged to small concerns in such a way as to facilitate the operation of the secondary market while at the same time protecting the interests of the small concerns.

(3) Lenders may, because of the profit potentials, make SBA-guaranteed loans simply to create a saleable asset.

(4) SBA receives complaints from investors who have paid a premium that prepayment of loans is destroying their anticipated yield.

In addition, there are often relatively minor mechanical problems, for example:

1. SBA recordkeeping for secondary market sales is based on a manual system. This limits the amount of data available for policy analysis and program evaluation.

2. SBA receives complaints that its purchase of defaulted loans is slower than required by the contractual agreement.

A number of these and other problems are addressed in two reports:

(1) The "Report of the Small Business Committee on Capital Access," a Committee which I established to advise me on ways to enlarge the supply of funds available to small business while lowering their cost.

(2) The April 25, 1983, General Accounting Office report, entitled "SBA's 7(a) Loan Guarantee Program: An Assessment of its Role in the Financial Market."

Please note in the appendix to this statement, SBA's June 24, 1983, response to the GAO report.

CONCLUSION

In conclusion, let me say that we are confident these problems are not intrinsic to the basic nature of the secondary market. Improvements can and will be made. We believe that the secondary market is an important component of our financial as-

sistance programs. I personally place a high priority on improving our efficiency in this area. As we strive to perfect the programs, we look forward to a cooperative working relationship with the Congress.

SMALL BUSINESS ADMINISTRATION'S POSITION STATEMENT OF THE GENERAL ACCOUNTING OFFICE REPORT ENTITLED, "SBA'S 7(a) LOAN GUARANTEE PROGRAM: AN ASSESSMENT OF ITS ROLE IN THE FINANCIAL MARKET" (RCED-83-96, B-211033 DATED APRIL 25, 1983)

The following are the small Business Administration's written comments on the subject report which are required by 31 U.S.C. Section 720.

GAO recommendation (page 36)

"Evaluate district office implementation of loan quality standards to see whether they are clear and applied consistently throughout SBA so that individual borrowers, who satisfy SBA's quality standards, are not denied credit."

SBA comment

Guidance to field offices on loan quality initiative have been provided through a series of memoranda and discussion sessions at various program meetings. This guidance has stressed the efforts to achieve quality through the care and professionalism exercised in the application of SOP guidelines and instructions. In each instance it has been stressed that credit decisions are based upon the exercise of prudent credit judgment, and that rigid additional criteria not called for in SOP's are not to be imposed.

The evaluation process within SBA program functions is the Regional Technical Review process. A memorandum will be issued within the next 30 days to all Regional Administrators advising of the need to evaluate this impact of the quality initiative in their RTR examinations. Long term evaluation of the quality emphasis can only take place as loans made under this direction become seasoned and their effect on delinquency and loss rates can be measured.

It must be noted that while consistency in application of credit standards is desirable, it is neither possible nor desirable to establish rigid criteria on the exercise of judgment on a case by case basis.

GAO recommendation (page 36)

"Accumulate data on 7(a) loan applications, approvals, and rejections and use this data, together with data on forecasted economic activity, to project future demand for 7(a) assistance. Activity data on applications, approvals, and rejections should also be used to monitor the consistent application of loan quality standards in SBA offices."

SBA comment

Information on loan demand is extremely difficult to obtain and measure in a meaningful way. As for SBA obtainable information, a system has already been implemented to provide on an immediately retrievable basis, nationally, regionally and on a district by district basis, accurate information on applications received, approved and declined, as well as those pending at any point in time. This system is automated and the information is available from the beginning of this fiscal year. We are now working with our automated systems personnel to develop a similar system for the accumulation of loan inquiry information.

GAO recommendation (page 66)

"Direct the Associate Administrator for Finance and Investment and the Director, Office of Secondary Market Operations, to develop procedures to clearly state SBA's goals and objectives in promoting the secondary market. Also, clarify functional responsibilities for overseeing the implementation of these objectives.

"Develop better procedures for keeping records of secondary market transactions, including service fees and prices paid by investors for loans. The Administrator should determine whether improved recordkeeping controls could be accomplished more efficiently by internal changes in SBA's procedures or by using the services of the FTA for all loans sold in the secondary market."

SBA comment

We concur in these recommendations, and are initiating the necessary study to accomplish them. It is anticipated that completion of study, development of meaningful objectives, and formulation of an efficient record system will require a period of from 90 to 120 days. We are proposing a target date of September 30, 1983.

GAO recommendation (page 66)

"Direct the Associate Administrator for Finance and Investment and the Director, Office of Secondary Market Operations, to develop a strategy for using the secondary market to offer small businesses the option of fixed rate financing. This strategy should address the desirability of actions such as the Minnesota Plan, the use of loan pooling, and the advantages and disadvantages of setting interest rates on fixed rate loans at the time of loan disbursement."

SBA comment

We concur in the development of a means to provide fixed rate financing through the secondary market. This recommendation was made by the Committee on Capital Access and has been accepted by the Administrator. The principal vehicle to accomplish this is considered to be loan pooling. Since this will require legislation, required legislative authority has been included as a part of the Agency's legislative proposals for this year.

Whether the Minnesota Plan, or similar initiatives to accomplish fixed rate financing can be effective is yet to be proven. The MSBFA has only now accomplished its bond sale no loans have yet been purchased. The interest rates involved, although fixed, may not be low enough in the current market to result in significant activity. Only the extension of the pilot program will provide an answer to this question.

GAO recommendation (page 66)

"Implement the recommendation of the Capital Access committee that would require lenders that sell SBA guaranteed loans to stipulate their methods of accruing interest and then continue to remit funds on this basis as long as the loan is active."

SBA comment

This recommendation has been adopted by the Administrator. Implementation will require revision of SBA Forms 1084 and 1086, secondary market documents. This revision is in progress in cooperation with the Office of General Counsel and the Fiscal Transfer Agent, Bradford Trust Co.

GAO recommendation (page 66)

"Determine whether SBA has the authority to implement the recommendation of the Capital Access Committee which would require the fiscal transfer agent to remit interest to the investor as calculated on a 30/360 basis, regardless of the actual interest accrual method used by the lender. If SBA has this authority, we further recommend that the Capital Access Committee's recommendation be implemented."

SBA comment

This recommendation has not been adopted but is under study. The principal beneficiary of such a change would be the fiscal transfer agent through ease of administration. Reaction among participating banks to this change is very mixed. At this time, we are unable to state whether it will or will not be adopted, but we believe that its adoption would not have a beneficial effect on the program, and its rejection would not have a detrimental effect.

GAO recommendation (page 66)

"Request from the fiscal transfer agent a formal proposal on how it could function as a central paying agent. Determine whether this proposal or the recommendation of the Capital Access Committee that would require lenders to remit principal and interest on a timely basis is the more preferable and act accordingly."

SBA comment

This recommendation has not been adopted at this time. There remains a question as to whether or not legislation would be required. It is also not clear whether participating institutions would accept the requirement. It must be recognized that this change would benefit investors and the fiscal transfer agent, and would only benefit the borrower in as much as it would have a material effect on secondary market sales. It would not benefit participating lenders. Since it appears that the principal complaint of those involved in secondary market sales is the lack of loans to purchase, it does not appear that rejection would have an adverse effect on the program.

GAO recommendations (page 67)

"We further recommend that if the Administrator decides to control servicing fees, as recommended by the Capital Access Committee, he take certain steps to

ensure that the Committee's intent of lowering borrower interest rates is achieved. Specifically, we recommend that the Administrator not establish a fixed fee but rather design regulations or procedures that limit the servicing fee as a function of loan size, premium to be paid, length of time the loan is held, and any extraordinary lender services to be provided. A period of testing should be carried out to determine the feasibility of controlling servicing fees in this manner.

"Agency comments and our evaluation

"SBA agreed with all but one of our recommendations and stated that the recommendations should prove very helpful in addressing some operating problems in the loan program. While in basic agreement with a proposal in our draft report to establish controls on the amount of lender servicing fees, SBA did not see a practical means for implementing it. However, SBA agreed that, after a period of testing, a means for implementing this recommendation may be identified.

"We modified our earlier proposal in response to SBA's comments. We now recommend that SBA test the feasibility of controlling servicing fees based on specific loan characteristics, should the Administrator decide to control servicing fees."

SBA comment

The basic recommendation of the Capital Access Committee to limit servicing fees has been adopted on a pilot basis. We continue to believe there is no practical way to control such fees on a series of factors including loan size, time loan held, and extraordinary servicing requirements. We are, however, now studying the question of including premium amount in the limitation, or as an alternative, prohibiting premiums entirely.

GAO recommendation (page 83)

"We recommend that the Administrator, SBA, change the current regulatory policy by either:

"Continuing to regulate interest rates through a national ceiling but with different benchmarks for fixed and variable rate loans or

"Eliminating the national maximum allowable interest rate and relying on procedures and guidance to field offices for determining the reasonableness of interest rates in their local areas."

SBA comment

Based upon the recommendation of the Committee on Capital Access, the Agency has instituted a pilot procedure in several regions eliminating the national maximum allowable interest rate. After a period of testing, it will be determined whether an across the board elimination is feasible. With regard to an alternative benchmark, while we agree that prime rate is a short term rate and not necessarily an appropriate benchmark for fixed rate term loans, we cannot ignore the fact that prime is the vehicle broadly used by lending institutions in the administration of their loan programs. SBA would be reluctant to force a change upon them without firm evidence of wide acceptance by banks.

TESTIMONY OF JAMES C. SANDERS, ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION, ACCOMPANIED BY EDWIN T. HOLLOWAY, ASSOCIATE ADMINISTRATOR FOR FINANCE AND INVESTMENT; AND JAMES B. RAMSEY, JR., SBA DIRECTOR OF SECONDARY MARKETS

Mr. SANDERS. Thank you, Mr. Chairman. Greetings to you and to Congressman Olin and to the other members of the subcommittee staff here.

Mr. NOWAK. Congressman Roemer has just come in also.

Mr. SANDERS. Oh, how are you, Congressman Roemer?

As you mentioned, Mr. Holloway and Mr. Ramsey are here with me at the table.

The secondary market is one of the SBA's most important tools in assisting small business. It is also one of the least understood programs we have, so I welcome this opportunity to examine all the parts here.

The first question that naturally comes to mind is what is a secondary market? In concept it is simple. It is designed to permit participating lenders to sell the SBA-guaranteed portion of a loan to an investor. Essentially, a participating lender makes a loan to a small business and obtains the SBA guaranty. The lenders that elect to sell the guaranteed portion seek a buyer normally through a broker dealer. An agreement is executed by the lender, the buyer, and SBA after the loan is properly closed and fully disbursed. This agreement extends SBA's guaranty from the lender to a subsequent good-faith purchaser.

Although some lenders have set up their own marketing operation, most lenders sell the guaranteed portion to or through a broker. Typically, brokers or others bid on the guaranteed portion, and the lender accepts the best available bid. The broker may then convert the guaranteed portion, through the use of the SBA-appointed fiscal and transfer agent, into a certificate. This certificate, in turn, permits resale to a new buyer who is generally a pension fund or other institutional account. As an alternative to using the SBA-appointed fiscal and transfer agent, many secondary market sales occur by direct placement.

What are the benefits? The principal benefit, of course, accrues to small business borrowers by virtue of the increased availability of lendable funds through the local lenders. This is made possible by providing funds directly from sources that would not otherwise be accessible for investment in small businesses.

The funds available for the financing of small concerns come from a broader base; and therefore the supply of funds is less likely to be interrupted by cyclical fluctuations in the financial markets. Competition is made possible in the origination and servicing of the small business loans without large commitments of capital from the lenders. As competition develops and improves, the terms of financing should become more favorable to the small business community.

Lenders have greater financial flexibility as a result of the liquidity provided by the secondary market. Therefore, their ability to continue providing financing to small concerns is enhanced. Lenders can substantially broaden their customer base with moderate capital commitments and therefore realize operating and financial leverage leading toward improved profits from small business financing. This is the most positive incentive for participation in SBA lending.

These benefits to small businesses have been well summarized in a recent GAO report which states:

> Sales of SBA-guaranteed loans in the secondary market benefit small businesses. Lenders are able to obtain funds from investors such as insurance companies, pension funds, and money market funds which traditionally do not invest directly in small businesses. For some small banks being able to gain access to these pools of managed capital is the difference between being able or unable to make an SBA-guaranteed loan. The secondary market process also has a leveraging effect, allowing lenders to reinvest the proceeds from sales in other small businesses. Last, the secondary market is used by some lenders to offer borrowers the stability of a fixed rate instead of a variable rate loan, and lower interest rates.

There are certain improvements we should talk about in the program operation. We believe that it is generally sound. As with any complicated program, however, there are improvements that could

be made. Accordingly, we are engaged in an ongoing effort to monitor and improve the program.

Some of the more significant problems include: First of all, the network for the operation of the secondary market may increase the fixed costs of financing in some cases; two, the SBA has the problem of trying to regulate the maximum rate charged to small concerns in such a way as to facilitate the operation of the secondary market while at the same time protecting the interests of the small concerns; three, the lenders may, because of the profit potentials, make SBA-guaranteed loans simply to create a salable asset; four, SBA receives complaints from investors who have paid a premium that the prepayment of the loans is destroying their anticipated yield.

In addition, there are often relatively minor mechanical problems. For example, No. 1, the SBA recordkeeping for the secondary market sales is based on a manual system. This limits the amount of data available for policy analysis and program evaluation.

Two, the SBA receives complaints that its purchase of defaulted loans is slower than required by the contractual agreement. A number of these and other problems are addressed in two reports. The first is, "Report of the Small Business Committee on Capital Access," a committee which I established to advise me on ways to enlarge the supply of funds available to small business while lowering their cost.

The second report is that of April 25, 1983, the General Accounting Office report entitled, "SBA's 7[a] Loan Guarantee Program: An Assessment of Its Role in the Financial Market."

You will note in the report that I have submitted the appendix to this statement is SBA's June 24, 1983 response to that GAO report.

In conclusion, let me say that we are confident that these problems are not intrinsic to the basic nature of the secondary market. Improvements can and will be made. We believe that the secondary market is an important component of our financial assistance programs. I personally place a high priority on improving our efficiency in this area. As we strive to perfect the programs, we look forward to a cooperative working relationship with the Congress, Mr. Chairman.

Mr. NOWAK. Thank you very much, Mr. Sanders. Would either of the other two gentlemen like to make additional statements at this time?

Mr. RAMSEY. No, thank you, Mr. Chairman.

Mr. HOLLOWAY. No, thank you.

Mr. NOWAK. All right. Let me try to get into the actual operation. Could you give the committee, Mr. Sanders, some idea of the costs that are associated with it, or could you run us through a typical kind of case?

Perhaps Mr. Ramsey could do that to focus on the kinds of financial incentives that are taking place out there in a typical case.

Mr. SANDERS. Mr. Chairman, may I let Mr. Holloway, the director of that office, take it step by step? I would hate to miss one of the steps involved.

Mr. NOWAK. Fine. Thank you.

Mr. HOLLOWAY. Mr. Chairman, perhaps I should just use an example involving a $100,000 loan.

Mr. NOWAK. Yes.

Mr. HOLLOWAY. If a $100,000 loan is made to a small business and that loan is, for example, 90 percent guaranteed by the Small Business Administration, then we have in effect a $10,000 unguaranteed portion and a $90,000 guaranteed portion.

If the lender elects to sell the guaranteed portion of that loan into the secondary market, he enters into an agreement with SBA and the investor buying the guaranteed portion. I will use an example in which the rate of interest is 13 percent, and let's say that the bank agrees that it will service the loan for the investor for a servicing fee of 3 percent. Thus, the investor buying the guaranteed portion of the loan gets an instrument that is guaranteed by the Federal Government and has a 10-percent return. The bank collects 13 percent from the borrower, deducts its 3 percent servicing fee, and remits the 10-percent net to the investor. Accordingly, the lender gets its note rate of return, that is 13 percent, on the unguaranteed portion which is $10,000, plus it makes a fee for servicing the guaranteed portion for the investor. Its total gross return then is the sum of the note rate of interest on the 10-percent unguaranteed portion, plus the amount that it makes by servicing the guaranteed portion.

Mr. ROEMER. What percent?

Mr. HOLLOWAY. Well, in the example I used, it would be 3-percent on the 90-percent guaranteed portion.

It arguably gives the lender a return of say nine times the 3 percent or 27 percent plus his 13 percent on his unguaranteed portion. I say arguably because again that is a gross rate of return, not a net. The lender has the responsibility to service the loan. This involves people who are paid perhaps $30,000 or $40,000 a year as loan officers to work with the account, to work with the borrower, so there are substantial expenses involved in servicing one of these accounts.

Mr. NOWAK. That is, I think, a clear example.

Let me ask you further. You know, we look at this program as perhaps a mini-mortgage program, as housing mortgages, the FHA and VA loans, are packaged and resold. Do the banks have any front-end costs that they would tack on? Is there any discount in relation to what would be equivalent to points that are charged by the bank?

Mr. HOLLOWAY. Mr. Chairman, we do not permit at SBA "points," per se. There is one charge of 1 percent which is a guaranty fee, and we charge that to the lender. We do permit the lender to pass through and recoup that cost, but in addition to that, the charges are for actual services rendered and not say three points, four points, et cetera.

However, after the loan is made, and in some cases a bank may hold one of these loans for 6 months or 6 years before having a liquidity need and deciding to sell that asset, but at the time that he sells the asset, he has been a risktaker for some period of time, and like any security, the interest rates have changed, and the value of that security may have gone up or it may have gone down, so in some cases, to respond directly to your question, it may be that a

premium is involved, or if the interest rates have gone the wrong way, it would be necessary to discount it in order to sell the paper into secondary markets, so in addition to the servicing fees, there are some premiums or discounts associated in the sale of this paper.

Mr. NOWAK. Well, I mentioned that because of course, one of the things we try to do which I would think would benefit everybody would be to have a program that was more widely used. You could perhaps get better control of the whole mechanism which would in turn somehow lower the cost to the borrower. For a small business, you know, a point makes a difference in everything that he is going to be able to do in the future.

I was wondering if you had any ideas of how that could be accomplished in the future.

Mr. SANDERS. Mr. Chairman, I was going to respond a little bit. This is a concern of ours throughout the entire process of analyzing the final cost to the borrower. As you know, in the past some consideration has been given to bringing the permissible interest rate down to simply local prime or New York prime or whatever you will. When you go too far in trying to control or establish the rate, you then begin to drive the lenders out of the market. You can be self-defeating in this, so you have to be careful to try to achieve a broader base of interest as well as being fair.

We had, also, of course, a recommendation from the advisory committee that gave me the report on capital access, and that held up two concepts that we have been considering for some time: first of all, that the cap on the lending rate was really not a cap but a target that was used by many banks. They automatically put 2¼ on top of prime, or 2¾ depending on the terms. It was not a competitive environment. We felt that we should experiment with taking the cap off and seeing if we wouldn't get a more competitive rate as a result.

In our pilot project of the preferred lender program where we used this device and one more that I will speak of in a moment, we so far have seen that the average cost is a little bit under 2 points over prime which is better than the target within the cap we had before. So far that would appear to be a step toward a more competitive ratemaking.

We also introduced a control on the fee of 300 base points for the banks which turned the loan over in the secondary market in the first 6 months. We felt that was fair to try to control. Those were making rapid turnovers and we didn't use the same device for those after 6 months.

Then we plan a pilot program beyond the preferred lending program on both the 300 basis points and the regulated cap on the rate, so we are trying to experiment with these methods of controlling the cost.

Mr. ROEMER. Mr. Chairman, would you yield for a brief question on that one point?

Mr. NOWAK. Yes.

Mr. ROEMER. You gave a litany of two or three examples of things that your organization was experimenting with, and I find that fascinating. Let me make sure that I understand the second

point you made. You limited to 300 base points the quick turnover operations? Am I right?

Mr. SANDERS. As a fee.

Mr. ROEMER. As a fee.

Mr. SANDERS. In a pilot program.

Mr. ROEMER. Yes. So you didn't do this universally or across America, just in some selected marketplaces?

Mr. SANDERS. That's correct.

Mr. ROEMER. If the original lender outside of the secondary market kept the loan longer than the 6 months, what were the limitations on basis points then for a fee?

Mr. SANDERS. We didn't have any limit on that if they kept it.

Mr. ROEMER. So that was market negotiable.

Mr. SANDERS. Right.

Mr. ROEMER. OK. Thank you.

Mr. NOWAK. Just to follow up on that, there is an experiment out there with a Minnesota plan which I guess was a pilot program intended to provide smaller firms in Minnesota with so-called long-term, fixed-rate asset financing. I understand that the Minnesota Small Business Finance Agency is required to sell taxable long-term, fixed-rate bonds to investors in terms of $5 to $10 million lots, and the proceeds from those bonds are used to purchase the SBA-guaranteed loans on the secondary market.

Are you aware of the success of that program, how broad that has been?

Mr. SANDERS. That has been a little slow in getting off the ground, Mr. Chairman. However, I think they issued 15 million dollars' worth of those securities. I am sure Mr. Holloway could comment some more on that. I think they ended up using a different fund, didn't they, than the original——

Mr. HOLLOWAY. Yes, sir; they did. Your figure is correct. It is our understanding that they issued 15 million dollars' worth of bonds which I believe were sold. The majority or all of them were sold to the pension fund in the State of Minnesota, in one of the pension funds. However, the $15 million is available, and we understand that in the recent 30 days or so approximately five or six transactions are beginning to move through.We are watching that experiment with interest because it does provide in that particular plan a long-term, fixed-rate, fixed-asset financing. There is no variable rate in that program.

Mr. NOWAK. Thank you. Our program has used approximately 20 percent of these; the 7(a) program is sold out through a secondary market. Are you aware of what the percentage of the mortgage funds are through FHA sold out?

Mr. SANDERS. I don't happen to know. Does either one of you know the percentage of them?

Mr. NOWAK. I would think it is very, very high.

Mr. SANDERS. Mr. Chairman, I think that is mistaken, that the percentage has been steadily increasing in the use of the secondary market in our lending fund, has it not?

Mr. HOLLOWAY. It has increased recently, Mr. Administrator. It has been in the neighborhood of $500 million per year for about the last 3 years. We have noticed in the most recent data month that it

is up now to around $50 million again which would give you around $500 million to $600 million——

Mr. SANDERS. Yes, but of course, $500 million against—a steady level against a dropping base is a higher percentage with the recession——

Mr. HOLLOWAY. That's true.

Mr. SANDERS.The drop-off in demand.

Mr. NOWAK. I am just wondering what incentives would move this program out further, and we have some testimony on that coming.

Mr. SANDERS. I might add that we have some. I think not only ourselves but some of the people who are active in the market will have some suggestions in their testimony later.

Mr. NOWAK. But you do see this program as getting a more acceptable kind of base out there in percentage terms at least.

Mr. SANDERS. The percentages went up in the last 3 years from 15.9, 17.1 to 22.6. Now, there was a drop off in the year before that, but of course, this is again as Mr. Holloway pointed out, the amount of secondary sales kind of held pretty steady, but the base was dropping as the recession demands set in, but I think it indicates a stronger interest in an understanding of the secondary market. We are hopeful anyway, and of course what we want to do is make it more attractive and easier to use.

Mr. NOWAK. I suppose as the banks and their liquidity individually get tighter, they will look at this program for more leveraging as they try to adjust their own reserves and balances.

Let me at this time turn to Jim Olin from Virginia, who has expressed a great interest in this matter.

Mr. Olin.

Mr. OLIN. Thanks, Mr. Chairman.

I would like to get a little better understanding of what the interest of the SBA is in the secondary market activity. Are you saying that now about 22.6 percent of the guaranteed portion is being moved into the secondary market?

Mr. SANDERS. In guaranteed loans, 22.6 percent are being used.

Mr. OLIN. What is your objective here in this respect?

Mr. SANDERS. Well, we feel it is a great advantage, Congressman, to the small business borrower because it gives his bank liquidity that they don't otherwise have——

Mr. OLIN. Yes.

Mr. SANDERS.—which is particularly true in a lot of the small banks out in the rural areas where there is a lack of liquidity. They make one loan and they sell off the 90-percent portion and get it paid back into the bank and make another loan, and it recirculates so they can make more small business loans.

Mr. OLIN. Yes; so why is it that they are not utilizing this to a greater extent?

Mr. SANDERS. Well——

Mr. OLIN. I know you have covered that, but would you go over that again?

Mr. SANDERS. I think those kinds of banks are probably the ones who use it the most percentage wise.

Do you have some observations on that, Jim Ramsey?

Mr. RAMSEY. Yes. I feel that much of it is educational. I think that many people are not aware that it is there. I think that one of the main problems is that we have to explain. It is a complicated situation as the Administrator indicated a moment ago. It is the kind of thing that is a little difficult to really get across at the first go round. You have to come back and explain again, again, and again the processing, and I think that is the main thing we need to get across; the educational part of it which has really not been done.

As the Administrator has also indicated, the use of this program by the outlying bank areas—well, I will give you some statistics—some 2,300 banks in the country have even sold off one SBA loan, and of that number, some 700 banks represent about 80 percent of our total market, so you can see that it still has not expanded. Of those, most of them are in areas other than large urban development. I think there are several reasons for that. The shortage of capital, if you will, has not been as great in the large urban areas as money has been in the suburban areas and in the rural areas.

Mr. OLIN. Is there any evidence that the lenders are not finding this a profitable thing to do, that the threads are too tight to make it practical to make these sales?

Mr. RAMSEY. I think originally that it was much too difficult for most banks to operate in this. The amount of paperwork necessary, the amount of staffing that took to examine the loans involved were just as great as a larger loan, and they felt it was not productive to the bank to spend the amount of time necessary——

Mr. OLIN. Yes.

Mr. RAMSEY. To do the paperwork on this. Also, the movement of the paperwork they found was objectionable, and that was the original state of the program, and we have done quite a lot to clear that up so that the paperwork is down to a minimum. By the same token, I don't think that has clearly been utilized by the banks themselves. I don't think they are aware of it in many cases.

Mr. OLIN. Yes. You haven't talked much about how you try to manage this rate structure and the service-fee structure—or do you manage it—to try to stimulate activity in the secondary market.

Mr. SANDERS. Well, I think that the experiment of trying to control the fee that is used by those who actively use the secondary market and turn it over in the first 6 months is a step forward in that direction.

Mr. OLIN. Yes.

Mr. SANDERS. Congressman, there is some testimony in here about some of the problems that we have. I believe that the areas that we are largely concerned with right now are methods in which we can if you will clean up the security, make it a little more desirable, make it clear what the liabilities in buying this particular security are. We feel that we can make some improvements. Also, occasionally, some of these problems are very small in the number of complaints we get, but we are aware that there are some areas in which these securities are sold without full disclosure and full information to the investor. They are sold by people who are not really maybe as reputable as they might be. They are not members of any kind of broker-dealer organization. Remember, these are

exempt securities. They are not regulated. We can't regulate the securities industries——

Mr. OLIN. Yes.

Mr. SANDERS. But we can clean up our own certificates, so to that extent, we are trying in several ways to find methods to make this a more desirable security.

Mr. OLIN. Yes.

Mr. SANDERS. More desirable is going to get a lower rate, and passing that lower rate back to the borrower will achieve what we want to achieve.

Mr. OLIN. We might pick up some ideas on that with the additional testimony.

Could I ask you one more question, Mr. Sanders? You have referred to one of the impediments here; the fact that you have a manual system of recordkeeping with regard to something. It isn't quite clear to me what you were talking about.

Mr. SANDERS. Yes, I——

Mr. OLIN. If that is an impediment, what is keeping you from mechanizing it?

Mr. SANDERS. Would you like to comment on that?

Mr. RAMSEY. Yes.

Mr. SANDERS. I will let Mr. Ramsey get into detail on that a little bit.

Mr. OLIN. I didn't quite catch the reference.

Mr. RAMSEY. I would like, if I may, to go back a little bit to the origination of this. As it came into being in the early 1970's, the possibility of being able to move the guaranties from the banks to the hands of the third parties, the primary customer base because of the inability to move the paper and because literally the mounds of paper that it took to do this were prohibitive, and in order to do it. Let's say that in the early days some $40 to $60 million a year was only utilized in this capacity, it was felt that it was much too cumbersome, so the customer base itself was made up largely of small credit unions, some larger individual accounts, small insurance companies. That was approximately some 95 percent of that customer base.

There has been a complete change in that customer base. About 95 percent of it today is held by the large institutions, and they have insisted that before they can put it in their portfolio it must be of a better nature in order to handle the paper at all, to make sure that payments do come in at the same time and that they do derive certain benefits.

Mr. OLIN. Yes.

Mr. RAMSEY. But certain State pension funds want to make a direct investment in small business, but obviously they are prohibited to do it if the paper itself is not of a nature that they can put into their portfolios.

What has happened since we originally put this into effect is we have not made it mandatory to change the paper to accommodate the large institutional account. We have left that open, so that we have two types of operations.

Now, I won't be technical in going into the names of the forms that we use on this, but on one of them still we do allow the form

in the original to be done, and that is not a computerized operation.

Again, you have to understand the reasoning for this, and if we do change the coupon rate, we have the variable terms of the loans and so forth, and for many reasons, we have allowed that to remain in the old way of doing things if you will, so that it is done manually. It is done actually by the district offices of the SBA bringing together the totals at the month and in turn passing it on to the regional, and they in turn pass it on to me in New York.

The other side of this in the cleaning up that we referred to a minute ago, the certificate form to make it easier for the large institutions to get involved, is not a mandatory system, but while that has been done and is now being used roughly by 55 to 60 percent of our total involvement. It is fully computerized, so that we do have retrieval on that on instantaneous retrieval, but it is not all together. It is in two forms.

Now, is that clear, Congressman?

Mr. OLIN. Well, not exactly. Are you planning to move this manual work to computerized form, or is it so small that it isn't worth the effort to program it?

Mr. SANDERS. Well, I would like for Mr. Holloway——

Mr. OLIN. It is very strange these days to have any portion of banking that is not up to date with regard to information handling.

Mr. SANDERS. Yes, it is. We have some things in the agency that are not up to date.

Mr. OLIN. It is worth bringing that up. Maybe we could encourage you to correct that.

Mr. SANDERS. I appreciate the encouragement. There are some particular problems with the variety of the loans and the variety of terms and sources here, but maybe Mr. Holloway can speak to that.

Mr. HOLLOWAY. Mr. Congressman, we do have under active consideration right now the issue of whether or not we ought to force all of these transactions to go through a fiscal and transfer agent. No final decision has been made on that.

Mr. OLIN. Yes.

Mr. HOLLOWAY. Indeed, before doing such a thing, we would publish proposed rulemaking and take comment from the financial community and the brokers and the dealers and everyone involved in the process, but we do have that under consideration.

Mr. OLIN. OK. That's all I have at the moment, Mr. Chairman.

Mr. NOWAK. Thank you very much.

Mr. Roemer from Louisiana?

Mr. ROEMER. Thank you, Mr. Chairman, from New York. No, thank you, Mr. Chairman. [Laughter.]

A couple of quick questions. You gear my thought up. You have pointed out clearly the potential for increased access to funds on the part of small business because of the expansion of the secondary market and the increase in liquidity in the local banks. You pointed also to some experiments that might lend to a lower interest rate in fact for the borrower.

What are the down sides to the borrower in this operation as you see them? For example, let me tell you what planted this small de-

vious seed in my mind. It is point 4 under your more significant problems which you say,

SBA received complaints from investors who have paid a premium that prepayment of loans is destroying their anticipate yields.

Now, I don't know as much about your program as you do obviously, but it seems that it is possible for someone to take a guaranteed loan and then pay it off at a date earlier than originally thought, and that leaves the secondary marketeer in some sort of a bind.

Mr. SANDERS. That's correct.

Mr. ROEMER. Would you, in order to facilitate secondary markets, remove the right of the borrower from early or prepayment of the loan?

Mr. SANDERS. No, I don't think that's the direction in which to move, Congressman. The real problem is if the buyer of that certificate or that security doesn't know that it could be paid off early, prematurely his anticipated return would be destroyed. It would be considerably less. He has got to know that, and I don't feel that in all cases there has been full disclosure of this. It seems to me that to remove the right of the borrower to renegotiate his loan isn't the right way to go, but we should see that the investor knows that he is dealing in this kind of security.

Mr. ROEMER. Well, I agree with that, and I just wanted to hear you agree with that also.

Mr. SANDERS. Yes.

Mr. ROEMER. You make in the same list of 4 major problem areas and I quote:

Lenders may because of the profit potentials make SBA-guaranteed loans simply to create a salable asset.

Now, this goes back to an earlier brief comment you and I had with the rapid turnover, for example. What kind of evidence with problem No. 3 do you find?

Mr. SANDERS. Well, I am going to again pass the buck to Mr. Holloway a little bit. This is, as you know, a problem that we recognize. I think it is something that we can control. We have had discussions on the idea of cracking down on a few known games players.

Mr. ROEMER. Yes.

Mr. SANDERS.With SBA who if you have got a small institution, or large even, are obviously trying to play it for their own benefit totally and not play by the rules then I would be for eliminating from the program. Then we get all kinds of legal advice that the due process isn't being served and that these criminals should be let go.

Mr. ROEMER. Yes.

Mr. SANDERS. But before launching into a whole philosophical tirade that I am liable to do, I would rather have Mr. Holloway tell you a little bit about how extensive this is. I really think he has a better feel of it.

Mr. ROEMER. Now, Mr. Holloway, you are going to issue the tirade on behalf of Mr. Sanders. Right? [Laughter.]

Mr. HOLLOWAY. Congressman, I will attempt to be brief.

Mr. ROEMER. OK, good.

Mr. HOLLOWAY. Central to the policy in almost all of our financial programs, and indeed the policy of this Congress, is that we as a Government come in where the financing is not otherwise available. That is, if the private sector will accommodate a financial need without Government intervention, then it ought to do it, and we agree with that and are not in competition with the private sector.

Accordingly, bankers and other lenders must certify to us that they would not make the loan without the Government guaranty.

Now, we do not want to permit the simple slapping on of a Government guaranty on a bankable loan so that it can be, this process can be used——

Mr. ROEMER. Yes.

Mr. HOLLOWAY. So we have to be very careful in training our own loan officers and indeed in the seminars and all that we hold with the banks who we find are very responsive really in trying to follow the Government's many policies when they understand those policies.

We try, in seminars with them, to make known the policy and statutory basis of this requirement and get them to use the SBA program where it is truly one of those marginal financings or of such term that they would not make it without the SBA guaranty.

That's what that point goes to, and I believe we have an effective handle on that as a matter of the program as a whole.

However, there will be exceptions. There are times when arguably someone could look at one of these loans and say, "Well, my goodness. This is such a high quality loan the bank didn't need an SBA guaranty on this. They should have made this." It is a judgmental area that we are into, Congressman.

Mr. ROEMER. Let me just respond to this. I am about out of time, but I would like to respond further. It seems that point three was at the heart of any objective review of the secondary market system, at the heart of our concern that somehow in order to facilitate a secondary market, the screening process of the original loan might be compromised.

Now, you have addressed yourself to that, and I think very well. My question now is do you have an ongoing thorough examination of your loan portfolio guarantees to try to bring out, to highlight those? Maybe there are just two or three. Maybe there are 102 or 3 who abuse this system.

Mr. HOLLOWAY. The administration has in effect a regional technical review process whereby we go out to the various field offices and take a look at their activity and at what they are doing and attempt to measure them in terms of compliance. What we are really talking about is compliance. The policy in the statute is clear. We hope the policy in our SOP's and regulations is clear, and then it's a question of people actually implementing the program and doing it as it is written down on the piece of paper, and that's compliance, so we do have a number of reviews in fact. That's only one of the reviews. We also have, from time to time, an inspector general's office that does certain auditing, not only of our individual office out there, but indeed of my operation for example in Washington, so we are all looked at pretty good, I believe, Congressman. Although exceptions do occur where something slips

through the cracks, as a matter of installing systems, we have the systems in place that are adequately controlling this problem.

Mr. ROEMER. Do you have evidence that point three exists in your world right now, that lenders are in fact using your funds as a salable asset?

Mr. HOLLOWAY. Again, Congressman, this is a judgmental area. You can look at a loan and say "Gee, this loan shouldn't need an SBA guaranty."

Mr. ROEMER. Do you have evidence that anybody in your world that you review with an elaborate system of overlay and review is using these loans as salable assets? That should be a yes or a no.

Mr. HOLLOWAY. On an exception basis, yes.

Mr. ROEMER. So it does exist.

Mr. HOLLOWAY. It does happen.

Mr. ROEMER. Thank you.

Mr. NOWAK. Thank you, Mr. Roemer. I might just mention that the only reason I referred to Mr. Roemer's State is because sometimes it is perceived in Congress because of Mr. Roemer's very, very slight accent that people think he is from Brooklyn. [Laughter.]

I wanted to clear that up very readily for our witnesses here today.

Mr. ROEMER. I'll say this, Mr. Chairman: I was interviewed by the British Broadcasting System the other day on the IMF loan, and the reporter assured me that I would be on the nightly news in London that night for 5 minutes, and he would have subtitles under everything that I said. [Laughter.]

Mr. NOWAK. Fine. Thank you.

Mr. Sanders, we and the other members as well who couldn't be here because of other markups and commitments, are very interested in seeing that we do everything we can to upgrade this program and provide that kind of security within the parameters of the program as it is instituted here to make it salable.

We know the problem of premature payout is accomplished I think through the FHA program. All those mortgages don't run 30 years either, so we have I think the ability to do that, and I know that you are putting in a great deal of effort, and you have included some suggestions to OMB to do this and hopefully we will be able to streamline the program which will result in the sale of these assets to companies and portfolio companies that buy them, and we will feel more and more confident that they are receiving a high-grade asset.

I think this program, when you combine it out there with many areas that have instituted industrial revenue bond program, whether they are at the county, city, or State level, and that in combination will provide perhaps a growing pattern of your start for the small business community and then the growth into other areas where you have a viable economic small business moving.

We appreciate your time and the interest that you have shown on this program and look forward to working with you as our other witnesses present their testimony. I am sure you will be interested in hearing, and perhaps we can have followup communication on this whole problem and see if we can aid you in structuring what I think will be as money gets tighter and tighter, a very viable pro-

gram in the next few years as we start to pay off a some $185 to $200 billion deficit, so this leveraging may become a very important factor, and we appreciate your time and effort in moving this so that when that happens—I don't even think when it happens but when it happens—this program will be solid and strong, and you will be able to move very, very high-grade securities.

Thank you very much for your testimony.

Mr. SANDERS. Thank you, Mr. Chairman.

Mr. NOWAK. Our next witnesses happen to be, as Mr. Roemer knows, from Louisiana, the Capital Bank & Trust Co. of Baton Rouge, La., Embree K. Easterly who is the president of that institution.

The Capital Bank is a $500 million bank which has been heavily involved in the SBA lending program since the beginning of the guaranteed loan program. Mr. Easterly is the past president of the very prestigious Independent Bankers Association, and he is a member of the SBA's Small Business Committee on Capital Access. We want to welcome you here, Mr. Easterly, and once again, your total statement will appear in the record, and you can move into your testimony.

[Mr. Easterly's prepared statement follows:]

PREPARED STATEMENT OF EMBREE K. EASTERLY, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICE, CAPITAL BANK & TRUST CO.

Mr. Chairman, Members of the Committee, my name is Embree Easterly. I am Chairman of the Board and Chief Executive Officer of the Capital Bank and Trust Co. of Baton Rouge, Louisiana, a 500 million dollar bank.

I am a past president of the Independent Bankers Association of America. I want to thank you for the opportunity to appear before this committee and express my views on a subject that I feel is very important to the small business community.

Capital Bank has been heavily involved in SBA lending since the beginning of the guaranteed loan program. We first heard of this program in 1970 and determined to use it to benefit the small businesses in Louisiana.

First, I would like to give you the benefit of our experience with the SBA loan program before discussing the main issue of this hearing—the secondary market. Without the secondary market our bank would not have been able to make SBA loans.

We presently have on our books 270 loans with a balance of $25,721,858.01. The volume of loans has fallen off during the last 3 years due to our economic conditions as our outstanding loans were over 40 million in 1979. We expect our loan demand to pick up as the economy improves.

I am attaching an article that appeared in our local paper concerning a jewelry store that was expanding into a new 5000 square foot building that is being financed with a conventional loan. The owners contribute their ability to obtain financing to open their first store to an SBA loan made by Capital Bank. There are many such stories in our files and I can assure you that our SBA borrowers are very appreciative of Capital Bank and the Congress for making this loan program available to them.

A scaffold rental company applied to us for an SBA loan in 1969. They were unable to expand their small struggling business because of their inability to get financing elsewhere. We made them a $350,000 SBA direct participation loan. SBA purchased 75 percent. This company has prospered and today has lines of credit in seven figures and their business is being sought by many financial institutions. The following schedule will give you an idea of the results of this one loan:

SCAFFOLDING RENTAL & ERECTION SERVICES, INC.

	1982	1981	1980	1979	1978
Gross sales	$32,369,484	$31,607,026	$33,535,342	$22,572,809	$21,886,194
Income taxes	839,086	684,767	1,201,397	218,192	52.452
Local taxes	86,717	79,832	74,126	37,297	27,232
Average number of employees	600				

I wonder if the SBA isn't a profit center for the Federal government. The 1 percent guarantee fee, the taxes paid by the successful businesses started with SBA loans and the taxes paid by the employees of these businesses may more than offset the losses on loans and the cost of the program.

The SBA guaranteed loan program can do for the small business what FHA and VA loans have done for the housing industry. I think we all should be working to sell this program, it is the only way many entrepreneurs can ever get financing to start a business and create new jobs.

There are only a few banks in Louisiana making SBA loans—many banks think that the applications are too hard to fill out and that they cannot get a loan approved. (This is not the case—my loan officers tell me that it is easier to fill out an application for an SBA loan than to fill out an application for a home mortgage loan—FHA or Conventional.) Because of this, Capital Bank has contacted its correspondent banks in Louisiana, we have over 100 throughout the state, and suggested that if they had anyone seeking an SBA loan, we would help with the application, close and service the loan and sell them 5 percent or ½ of the guaranteed portion. They get to keep the customer and can put up to $1,000,000 to work in their community with only a $50,000 investment. Thirty-three banks throughout the state have made joint loans with Capital Bank and the program works well.

Most of our loans are made with variable rates. When rates were high, many of our borrowers could not make the payment necessary to amortize the loan as agreed. We were able to get SBA's approval to let borrowers make the payment necessary to amortize their loans at 12 percent even though the payment did not, in some cases, pay the full interest. The bank carried this unpaid interest in an accounts receivable until rates went down and today most of these loans have paid the back interest and are being amortized with an extended maturity. Without this concession from SBA and the Capital Bank many of these businesses would not have survived as their cash flow was not sufficient to pay the high rate required to amortize the loan as originally drawn.

The secondary market is necessary if our bank is going to continue to make SBA loans. We do not have long term deposits that are needed to fund these loans. It is not prudent banking to fund long term loans with deposits that may leave the bank before these loans are paid. Most of our SBA loans are secured by real estate and the collateral is sufficient to liquidate these loans. Our problem is finding a source of funds. There are lenders who will make the large loans such as shopping centers and office buildings but few who will lend to the small businessman on collateral such as inventory, equipment, one purpose buildings, personal endorsement and second mortgages on residences.

I am attaching a list of the types of businesses we have financed through the SBA loan program. We have been able to bring money from the money market centers to fund these loans.

The secondary market helps everyone involved. The small businessman can get money from the money markets to invest in his business. The bank gets a fee for servicing the loan. The investor has a government guaranteed investment and the government has created more jobs and receives more taxes.

The small business needs a constant flow of funds and the secondary market can provide these funds at market rates. The secondary market works—we need more banks using it to help get our economy moving and create more jobs.

Mr. Chairman, I want to thank you and the Committee again for allowing me to testify and I will be happy to try and answer any of your questions.

LIST OF BUSINESSES FINANCED BY CAPITAL BANK'S SBA GUARANTEED LOAN PROGRAM

Building supply; building contractors; moving companies; auto dealerships; alarm systems; athletic clubs; nursing home centers; dry cleaners; restaurants (to include fast foods); service stations; child day care centers; photo supply; drug stores; Superette's—Food Marts, Quick and Handi's; grocery stores; chiropractic, doctor and den-

tist clinics; manufacturing mobil homes; feed store; auto parts; T.V. and radio sales & service; industrial lighting; refrigeration; shopping centers; filtration system; recreational and travel parks; office supply; pet shop and supplies; interior decorating; transmission centers; and retail stores: chair center, shoe store, Christmas house, tires, toy store, furniture, tile and marble, clothing, carpet, jewelry, tobacco shop, wholesale battery.

Ice machines, sales and service; wrecker service; insurance agency; attorney firms; welding and iron works; heating and air conditioning; industrial rubber; motorcycle dealerships; truck, trailer repair; swim/pool company; analytical and environmental testing; machine works and repair; forest products—logging, timber, hardwoods; computer sales and service; commercial warehouse and storage; boat rental and sales; flower shop; fabrication contractor; applicator of anti-corrosive linings; industrial seals, piping materials; gymnastic school; excursion boat; industrial training video production; farm equipment—sales and service; shipyard and drydocks; plastic fabricators; commercial parking; pest control; aerial industrial equipment sales and rental; galvanizing; marine repair; manufacturing plastic water well supplies; realty firm; equipment rental; consulting engineering firm; and sanitary service.

[State Times-Morning Advocate, Baton Rouge, La., Aug. 21, 1983]

JEWELRY FIRM PROSPERING DESPITE "TOUGH ECONOMY"

When Larry Whitesell and Kenneth Fellin move into a new building in September, it will be a highlight of the seven years that have passed since they became partners in a fledgling business in Baton Rouge.

When they started out, the old problem of choosing a name for the venture arose, and they settled on an unusual procedure—picking the middle name of each partner.

Thus was James Laird Jewelers born.

Some time in September, they plan to move into a new $1 million, 5,000 square foot structure at 690 Oak Villa, in the area of Cortana Mall. A grand opening is set Oct. 1.

Whitesell, president of the firm, and Fellin, vice president, describe themselves as "mass merchandisers without a discount image."

Looking toward their "eighth Christmas" as Fellin said he counts the years, the jewelry firm will have two locations and will have grown from two employees—the partners—to up to 65 during the peak holiday season at its three locations.

Laird's main store now is at 7017 Florida Blvd. and a branch is operated in Gonzales.

"When we first started out," Whitesell said in an interview, "we were aimed at the middle and upper class" customer. But when the economy "got tough," he added, "we repositioned ourselves toward the middle."

It is this type of flexibility to which Whitesell attributes the partners success.

Fellin and Whitesell, both of whom had worked in the jewelry field before, started their firm with a loan from the Small Business Administration, negotiated through Capital Bank, Whitesell said.

"It is a typical success story," Allie Pogue of the bank said of the venture. "This is the way we wish they would all work." Pogue and the partners noted that the jewelry firm is no longer relying on the SBA for its financing, but now is going through normal private financial channels.

The two partners, Whitesell said, had "experience and management ability, but we didn't have a lot of net worth," and "never could have made it without the SBA loan."

Pogue noted that the two men had something else going for them, the fact that they had expertise in different areas—one in business administration and sales and the other in the jewelry field. Differences tend to arise "when both partners do only the same thing well," Pogue noted.

How does a jewelry concern survive in times of a "tough economy?"

When "the economy becomes tight," Whitesell said, "people have a feeling they have to buy something for themselves, but they want something of permanent quality, something with lasting value or sentimental value."

And, Fellin added concerning purchases during difficult economic times, "most of it is adornment" rather than for investment purposes. "Rings, pearls, are most popular . . . people are going back to tradition."

Concerning their expansion move, Whitesell said the new structure would have a large, open, low "silhouette" design.

"We always look toward the clientele," said Malcolm Hodbett, architect for the structure. "We want the building exterior to represent the functional aspects of

what goes on inside." Red Stick Construction Co. will build the new quarters for the firm.

Both the Florida Street and the Gonzales locations will remain open after the new building is occupied. "We're not closing anything, Whitesell said."

TESTIMONY OF EMBREE K. EASTERLY, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, CAPITAL BANK & TRUST CO.

Mr. EASTERLY. Thank you, Mr. Chairman and members of committee, I want to thank you for giving me an opportunity to appear before the committee and express my views on a subject that I think is very important to the small business community.

I would like to say that this is the first time that I have ever heard anybody from Shreveport being accused of talking like a Brooklynite. Now, we have a lot of them in New Orleans that you can confuse. Isn't that right, Congressman?

Mr. ROEMER. You are absolutely right. You are a fine and intelligent man. [Laughter.]

Mr. EASTERLY. Thank you.

Mr. NOWAK. They have subtitles for people from Brooklyn, too.

Mr. EASTERLY. I see, OK. I would like to go through three of four things that came out in questioning. On the lender who sells a loan and gets paid off, early and he sold the loan at a premium and the investor takes a licking——

Mr. ROEMER. Yes.

Mr. EASTERLY. We have guaranteed at times when an investor would buy from us at a premium that if that loan paid out within a year we would rebate all or part of the premium, so that's something that can be worked out, it is just something that needs to be looked at.

Mr. Holloway, I sure would like some of this 3 percent servicing which you mentioned. We also have a lot of loans in our portfolio that we can make zero and minus servicing. We can't sell at a premium because we made them some time ago at a low rate, and we can't sell them without taking a loss.

Well, out of $25 million in loans we sell about 20 percent which seems to be about the average, but the comfortable thing is that we have loans we know we can sell if we need money, and we can sit there and be a lot more comfortable running the bank and we can lend out a little bit more money knowing that we have those loans that we can sell at par if they are variable rate, this is very helpful to us.

On making loans, we made a lot of loans, and you are going to say, "Well, gee, you can make these loans without the SBA guaranty."

Our bank has been making loans, and we have banks all over this country coming down to buy loans from us. We can sell any bankable loan to any one of a dozen banks, and we do sell them. We sell about 150 million dollars' worth of loans that are bankable loans, so in order to sell the nonbankable loan, if we have the SBA guarantee, we can sell it in the secondary market. If it is a good bankable loan, we can sell it to any bank because banks all over this country are looking for loans.

To get into my testimony, we have been heavily involved in this SBA lending since the beginning of the guaranteed loan program. We first heard of it in 1970 and determined to use it to benefit the small businesses in Louisiana.

First, I would like to give you the benefit of our experience with the SBA loan program before discussing the main issue of this hearing, the secondary market, but without the secondary market, our bank would not have been able to make SBA loans.

We presently have on our books 270 loans with a balance of over $25 million. The volume of loans has fallen off during the last 3 years due to our economic conditions as our outstanding loans in 1979 were over $40 million. We expect our loan demand to pick up as the economy improves.

Mr. ROEMER. These are SBA guaranteed loans.

Mr. EASTERLY. Yes, I am attaching an article that appeared in our local paper concerning a jewelry store that was expanding into a new 5,000 square foot building that is being financed with a conventional loan. The owners contribute their ability to obtain financing to open their first store to an SBA loan made by Capital Bank. There are many such stories in our files, and I can assure you that our SBA borrowers are very appreciative of Capital Bank and the Congress for making this loan program available to them.

A scaffold rental company applied to us for an SBA loan in 1969. They were unable to expand their small struggling business because of their inability to get financing elsewhere. We made them a $350,000 SBA direct participation loan. SBA purchased 75 percent. This company has prospered and today has lines of credit in seven figures, and their business is being sought by many financial institutions. The following schedule will give you an idea of the results of this one loan, and during the past 5 years their gross sales have been running about $30 million, and you will notice that they have paid about $3 million in taxes to IRS over the past 5 years, and they have had an average of 600 employees in that company.

I wonder if SBA isn't a profit center for the Federal Government. The 1-percent guarantee fee, the taxes paid by the successful businesses started with SBA loans, and the taxes paid by the employees of these businesses may more than offset the losses on loans and the cost of the program.

In my opinion, the SBA guaranteed loan program can do for the small business what FHA and VA loans have done for the housing industry. I think we all should be working to sell this program. It is the only way many entrepreneurs can get financing to start a business and to create new jobs.

There are only a few banks in Louisiana making SBA loans. Many banks think that the applications are too hard to fill out and that they cannot get a loan approved. Now, this is not the case. My loan officers tell me that it is easier to fill out an application for an SBA loan than to fill out an application for a home mortgage loan, either FHA or conventional, but because of this, Capital Bank has contacted its correspondent banks in Louisiana, we have over 100 throughout the State, and suggested that if they had anyone seeking an SBA loan, we would help with the application, close and service the loan and sell them 5 percent or one-half of the guaranteed portion. They get to keep the customer and can put up to $1

million to work in their community with only a $50,000 investment. Throughout the State 33 banks have made joint loans with Capital Bank and the program works well.

Most of our loans are made with variable rates. When rates were high, many of our borrowers could not make the payment necessary to amortize the loan as agreed. We were able to get SBA's approval to let borrowers make the payment necessary to amortize their loans at 12 percent even though the payment did not, in some cases, pay the full interest. The bank carried this unpaid interest in an accounts receivable until rates went down and today most of these loans have paid the back interest and are being amortized with an extended maturity. Without this concession from SBA and the Capital Bank many of these businesses would not have survived as their cash flow was not sufficient to pay the high rate required to amortize the loan as originally drawn.

The second market is necessary if our bank is going to continue to make SBA loans. We do not have long-term deposits that are needed to fund these loans. It is not prudent banking to fund long-term loans with deposits that may leave the bank before these loans are paid. Most of our SBA loans are secured by real estate and the collateral is sufficient to liquidate these loans. Our problem is finding a source of funds. There are lenders who will make the large loans such as shopping centers and office buildings but few who will lend to the small businessman on collateral such as inventory, equipment, one-purpose buildings, personal endorsement, and second mortgages on residences.

I am attaching a list of the types of businesses we have financed through the SBA loan program. We have been able to bring money from the money market centers to fund these loans.

The secondary market helps everyone involved. The small businessman can get money from the money markets to invest in his business. The bank gets a fee for servicing the loan. The investor has a Government-guaranteed investment, and the Government has created more jobs and receives more taxes.

The small business needs a constant flow of funds, and the secondary market can provide these funds at market rates. The secondary market works. We need more banks using it to help get our economy moving and create more jobs.

Mr. Chairman, I want to thank you and the committee for allowing me to testify, and I will be happy to try to answer any questions.

Mr. NOWAK. Fine. Thank you very much, Mr. Easterly. Let me ask you what percentage of your loans do you sell directly and what percentage do you sell through broker dealers, or do you use them at all?

Mr. EASTERLY. When we started selling loans in the beginning, there was no secondary market, so we went out to savings and loans and to insurance companies, and we sold these loans direct. We are now just going to brokers. We had about $2 million to sell 6 months ago. We went out and took bids from brokers and sold them to the brokers.

Mr. NOWAK. You mentioned in your testimony that this also benefits your bankers as an institution because it provides you with some flexibility regarding the liquidity level that you want to

stay at and can operate at. I would think that it gives you the ability to adjust to your deposit base whether it's moving up or down.

Mr. EASTERLY. Yes, sir.

Mr. NOWAK. That flexibility has proven, I would think, very helpful to you, and I am wondering if because of that you can see a future expansion of the use of the program with other institutions. As the market is changing and has changed in the year with deregulation coming into being and your ability to therefore attract the funds in the general market atmosphere that you are now working in, do you see this as beneficial?

Mr. EASTERLY. Mr. Chairman, I am really sold on this program. I was sold on it when I first heard that we could go out and make loans and sell 90 percent and make the type loans, our small businesses need. I have been in banking 44 years. I have been in commercial loans for 25 years, and there is just a void. This program really is needed. I have gone all over this country to bankers' meetings, ABA, IBAA, making talks on the benefits of the SBA loan program, and it has taken a long time. This program now is 30 years old, and it just hasn't taken off. It is a good program. It really is a good program, but we just have not been able to sell it to enough banks. Now, we don't need to sell it to all the banks. You take a few banks in Louisiana working the way we do, Mr. Roemer, and we can handle the State of Louisiana. We don't need all the banks. If a small bank doesn't understand the program and doesn't even want to look at the form. The form would scare me to death, but often in our bank, our officers will sit down with a customer and fill it out.

If we can get banks like ours to go out and work with these smaller banks in the smaller communities, I think we can really do a lot of good with this program, and I do think that we can sell it, to answer your question, and we can increase this program.

Mr. NOWAK. Would you have any suggestions, or when you talk to your loan officers, do they have any suggestions as to any possible streamlining of the program which would facilitate the whole process?

Mr. EASTERLY. If my wife wasn't here, I would tell a little story. [Laughter.]

But once you get a reputation, it is awfully hard to change it, and the reputation is that those forms are difficult to fill out. It is difficult to get the loan approved. SBA is hard to deal with, but those things are not true. They are a fine agency, and we have had such a good relationship with the Washington staff. They are real professionals, and the regional office in Dallas and in New Orleans. It is just a question of changing the reputation and getting banks like our bank to really get involved and let them know that this program is good and that it can help people.

Now, I have been trying to sell it. I don't have any suggestions. All the thoughts I have had, I have used, and I think it is true that we have done a good job in selling it.

Mr. NOWAK. Who were your customers for buying these guaranteed loans in the past? Who have they traditionally been?

Mr. EASTERLY. We have sold them to the savings and loans in Baton Rouge. We have sold them to insurance companies in Baton

Rouge. We have sold them to the investors—through the brokers, I don't know who they were sold to.

Mr. NOWAK. In terms of size, how do you package these to be sold, or do you do that at all?

Mr. EASTERLY. No. We sell them on a one-loan basis. Another thing we do, Mr. Chairman, we have in our bank $30 or $40 million of public fund deposits of the State, and we have to pledge securities to secure those deposits, and we pledge these SBA loans in packages of $1 million each to the State which is almost in effect like selling them, so we are in effect warehousing those loans, and that is another reason we have not found it necessary to sell those loans. We have used them in lieu of Government bonds to secure those deposits, but we sell them on a one-to-one basis.

There is one thing that I think would be helpful, and that would be to increase the size of the loans that would be guaranteed. You take a few years ago, I think the maximum was maybe $250,000. It is $500,000 now, but it really should be $750,000 to $1 million, and that's no more than it was a few years ago. With inflation and all now, the $500,000 just isn't enough.

Mr. NOWAK. Of course, on the other side of that, too, is the authorization levels which hopefully we can sustain. I envision this program being used more and more in the next 4 to 5 years, as the Government totally comes in. This has to be, I think, an escape clause for some funding, and hopefully those authorization levels which are projected to go down will stay up. I think this program will be used more and more and will be perhaps the only kind of dollars that are out there for the small business community. So I hope that your organization will support that when you talk to the bankers who are in this program and make that known to the administration, because if we don't have the authorization levels and we bump up against the ceiling, not only the secondary market programs stop but the whole program stops.

We appreciate your testimony, and let me now turn to Jim Olin.

Mr. OLIN. Mr. Easterly, I certainly enjoyed your testimony.

Mr. EASTERLY. Thank you.

Mr. OLIN. It is always nice to hear from somebody who has such a positive attitude. I think that's great.

You made one suggestion on how the guaranteed loan program might be improved which would be largely by raising the maximum loans that could be granted. Do you have any other ideas about what the SBA ought to be doing to improve its image? You indicated that it has, for one reason or another, an image that is difficult to deal with.

Mr. EASTERLY. Well, the image is changing.

Mr. OLIN. Yes.

Mr. EASTERLY. When we first were involved in this—it has been 12 or 15 years ago, and you gentlemen would know it if you were here—it almost took a Congressman to get a loan approved; it has evolved from that now.

If somebody comes to us and says "Hey, I've got a friend, Buddy Roemer, who will help me get that loan," we tell him, "Well, you go to somebody else because we do not want to get politics involved in our making loans because we want this loan to stand on its own."

That image is changing. It just takes time to change it, and I think that we have a fine administrator now. I don't even know if he is here yet. I hope he is so he will hear that. [Laughter.]

Mr. NOWAK. He came back to hear that. [Laughter.]

Mr. EASTERLY. We have had some fine ones in the past, don't get me wrong, but he is doing a good job, and I think we are changing this image, and I think that what comes out of this committee and all is going to help change it, but these banks have just a mental block to the Government programs and all programs connected with the Government. "We don't like the IRS. We don't like EEOC." Anything that has to do with Government is a problem, but there are many, many, many good Government programs that we need to use, and this is one of them. You know, it takes a lifetime to build a reputation. You can't build your personal reputation overnight. You just have to do it by your actions and your deeds, and finally after all, they are going to say, "Well, hey, that man has character." I think that is what it is going to take here. It is just going to take time. You just can't do it overnight.

Mr. OLIN. You don't see anything unusual in the fact that only 20 percent or so of the guaranteed loans are sold in the secondary market.

Mr. EASTERLY. I think that's great.

Mr. OLIN. Yes.

Mr. EASTERLY. It enables me to sleep much better at night knowing that I have those loans in my portfolio, and I can lend more money out, and I can retain those loans, knowing I can sell them.

Mr. OLIN. Yes. You are not seeing anything in the program that is impeding the sale. The fact that more of them aren't sold is natural circumstances. You don't need the liquidity or you have got them pledged in some other way?

Mr. EASTERLY. A lot of banks today, in fact banks all over Louisiana, are calling us for loans. They want to buy loans. The large banks in Chicago and New York and Detroit are coming down and saying, "We want to buy loans," so today we do not have the need for it that we might have, if as the chairman says we start funding——

Mr. OLIN. Some other time, yes.

Mr. EASTERLY. You know, the Government requests and that we could run short of money.

Mr. OLIN. Yes.

Mr. EASTERLY. Having that program available, whether we use it or not, will make this program go.

Mr. OLIN. Yes. Fine, thank you very much.

Mr. NOWAK. Mr. Roemer.

Mr. ROEMER. Thank you, Mr. Chairman.

Mr. Easterly, I want to join with what the chairman and Mr. Olin from Virginia said that your testimony is very fine being out in the real world—that means outside of Washington—working this program. Your testimony is well received by this committee.

I have a couple of quick questions. First, in regard to the suggestion that you made on those second mortgagors who paid a premium and then signed prepayments or early payment of the loan, would you amplify that for a minute as to what your bank does in that regard? You said earlier. I would like you to say it again.

Mr. EASTERLY. OK. We have on occasion sold loans at a premium.

Mr. ROEMER. Yes.

Mr. EASTERLY. Now, when we go to sell our loans—we have a portfolio back there now that if we sold some of them, we would take a loss on them.

Mr. ROEMER. Yes.

Mr. EASTERLY. Some we would make a good profit on, but if we sell this—if we have a loan and we can sell it at a premium, and this investor pays two points—it is a $100,000 and he pays us $2,000 premium, $1,000 premium, $500 premium, any amount—if that loan, goes into default and we ask the SBA to pay it off or if for any reason this man sells his business or he gets his business going good and refinance's conventional and he pays that loan off—let's say it happens in a month, and he has paid a $2,000 premium and he hasn't even collected a payment, and I am sure that has happened. We have told him that if it pays off in less than a year, we will refund you that $2,000.

Mr. ROEMER. Yes, in the secondary market, you protect against premiums paid against early repayment of the loan.

Mr. EASTERLY. Now, don't misunderstand me.

Mr. ROEMER. OK.

Mr. EASTERLY. We sell this through a broker.

Mr. ROEMER. Yes.

Mr. EASTERLY. I don't think we have ever done it if it is sold through the broker——

Mr. ROEMER. OK.

Mr. EASTERLY. But if we go to their savings and loan in Baton Rouge——

Mr. ROEMER. Yes.

Mr. EASTERLY. He pays a premium, we will make him a deal that if that pays off in 6 months, we will give you, say, half of it back.

Mr. ROEMER. I see.

Mr. EASTERLY. Or give it all back if it pays off in less than 6 months.

Mr. ROEMER. But do you believe that those who purchase your loans in the secondary market realize that early payment is a possibility?

Mr. EASTERLY. Oh, definitely.

Mr. ROEMER. OK.

Mr. EASTERLY. Most of these people who now are buying in the secondary market are investors who really know what they are doing.

Mr. ROEMER. OK. They are sophisticated.

Mr. EASTERLY. Yes. They know what they are doing.

Mr. ROEMER. Very good. Is there any reason other than your feeling of comfort or the necessities of your bank in terms of liquidity and ratios that you have to maintain that you limit your resale now to about 20 percent of your SBA guarantee, or is that just something that has come about?

Mr. EASTERLY. It has just come about. It is because we are not making as many loans as we would like to make.

You know, through the SBA guaranteed loan program, our bank is making a limited amount of loans. If there were enough loans in Louisiana, we could make every one of them.

Mr. ROEMER. Yes.

Mr. EASTERLY. Particularly, if they were in the Baton Rouge area where that account would come with us because they will carry the 10 percent with us in compensating balances.

Mr. ROEMER. Right.

Mr. EASTERLY. So if we sell off that 90 percent, then we can make $100 million today. We use $10 million of our bank's money, we would probably bring in $10 million in deposits, and we sell off that 90 percent or that $90 million there is no limit to the amount of loans that a bank can make if he can make good loans, and they are reasonably successful.

Mr. ROEMER. Right. There are no restrictions on the part of SBA to a percentage of your portfolio that you can resell?

Mr. EASTERLY. No.

Mr. ROEMER. OK. My final question is about other Louisiana banks without naming names, obviously, particularly Shreveport names. Your bank is a pretty good size in Louisiana banking circles. I think there are 286 banks in Louisiana, and you must rank where—in the top 20—the top 15?

Mr. EASTERLY. The top 15.

Mr. ROEMER. OK. The impression that you gave in your testimony, written and spoken, was that one of the big problems in this program was lack of knowledge. You didn't use the word ignorance, but in banking circles about how easily this is done and how much it helps the local community.

Is any progress being made? You talked about 100 corresponding banks within our State—that is about 1 out of 3 banks in the State—and yet you talk of only 33 who have done joint lending with you. Are you confident that that is changing in our State? Now, let me just leave it at home.

Mr. EASTERLY. I think so. I think it is changing, and I think it is changing because when we started making these loans, we were a $100-million bank. We are a $500 million bank now. That has been 10 years.

Mr. ROEMER. Yes.

Mr. EASTERLY. And this program has been good for us.

Mr. ROEMER. You have gone from $100 million to $500 million in less than 10 years.

Mr. EASTERLY. In less than 10 years.

Mr. ROEMER. Because of the SBA loan program?

Mr. EASTERLY. Oh, well——

Roemer. No, but. [Laughter.]

Mr. EASTERLY. But it has been helpful to us. It has helped our image with the other banks——

Mr. ROEMER. Yes.

Mr. EASTERLY [continuing]. Throughout the State because we have helped them with loans that couldn't be made any other way. An officer of the largest bank in Baton Rouge who is a good friend of mine, 10 years ago we talked, and he said, "Well, we looked at that, and we are not interested in making those loans."

After we started getting involved with it a few years ago, they put in a department to make SBA loans. Now, that was 2 or 3 years ago. I don't think it has been successful. You have to be really sold on this program. You have to sell your loan officers. You have to sell your board, and your whole bank because you are making loans there that in the past you would not have been able to make, so you have to change your philosophy, and you have to know that you are going to take a few more losses. You can't make loans like this if——

Mr. ROEMER. What is your default rate?

Mr. EASTERLY. On our total portfolio it is about two-tenths of 1 percent. On these loans I could not tell you what it is, and I am not sure that it would be——

Mr. ROEMER. I don't want to put words in your mouth.

Mr. EASTERLY. No, I was going to give you some figures.

Mr. ROEMER. But I was going to try.

Mr. EASTERLY. Out of the $25 million that we have on our books today, this year the bank has charged off $12,000, so the SBA then has charged off 90 percent more than that.

Mr. ROEMER. Yes.

Mr. EASTERLY. Now, that to me is not enough.

Mr. ROEMER. Yes.

Mr. EASTERLY. But we have taken more losses in the past because as these loans get older, of course, the chance of them paying off are better, but I would like to see SBA set a target and say, "OK, we want to take a 3-percent loss or 2-percent loss, and today I don't have the figure, but a 5-percent loss in banks, and banks bear that in mind. If you are willing to take a 5-percent loss on these loans, we are willing to take it because we can help more people that way.

Mr. ROEMER. Yes.

Mr. EASTERLY. We can sit there and make loans and know we are not going to take but two-tenths of 1 percent in losses, even though this is a second mortgage and inventory type collateral, you can't make a long-term loan on the collateral as a regular bank loan.

Mr. ROEMER. Oh, you are saying a fine line between aggressiveness and foolishness in these loans, but you think the SBA if anything is not aggressive enough.

Mr. EASTERLY. No. A few years ago—I don't know the policy now because we don't have the demand today, but hopefully we can get the demand back up, but at one time one of the previous administrators told us, "You need to take more losses."

Mr. ROEMER. Yes.

Mr. EASTERLY. "You are too conservative."

Mr. ROEMER. Very good. I want to thank you again for your testimony. It was excellent.

Mr. NOWAK. Mr. Dreier from California has been a member and is very interested in this, and I wanted to give him some time to assimilate——

Mr. ROEMER. A Republican slipped in.

Mr. NOWAK. But a very moderate——

Mr. DREIER. Thank you very much, Mr. Chairman. I wouldn't want my exchange in any way to be interpreted as an attempt to bifurcate the State of Louisiana here. I know that State rights

issues are very important, and I am a strong proponent of it, but I don't want to intercede with you two, but I do have a couple of questions that I would like to ask briefly, and I, too, enjoyed your testimony.

I am curious to know if the existence of the secondary market itself has had a salutary impact on the goal of actually bringing interest rates down for borrowers.

Mr. EASTERLY. It hasn't hurt. It hasn't hurt.

Mr. DREIER. You can't see a direct correlation though?

Mr. EASTERLY. I think that it probably has because let's say the maximum rate today—New York prime is what—11 percent? So if we make a loan at prime plus 2 percent, we would have 13 percent. If I went out on the market today and made a loan—let's just say a banking loan—that loan today, we would probably charge 14 percent on it.

Mr. DREIER. Yes.

Mr. EASTERLY. We make loans a little bit less with these guaranteed, so I think it sells.

Mr. DREIER. Have you been able to sell any loans with less than a 90-percent guarantee?

Mr. EASTERLY. No. In fact, I don't think we are permitted to sell the unguaranteed portion. I think we have to be at risk on that.

Mr. DREIER. Yes. You touched on the issue now that Jim Sanders has left of SBA being a profit center for the Federal Government. I am curious to know if you have any idea as to what level of revenues we actually could see enhanced by the Government due to this program.

Mr. EASTERLY. I would love to see some figures on that. I have tried to do it in my bank, and I have it here. The loans that we had made at that time and kept up with the number of employees that these borrowers had at the time they applied for their loan, how many new jobs they said they would create and then 2 years later actually how many jobs they had created, and it really is—you would be surprised of the actual number of new jobs created by these loans, but nobody has kept that. The only figures that SBA has I am sure are the losses. We take these losses——

Mr. DREIER. Yes.

Mr. EASTERLY. Of course, you have to keep those records, but if we could go out and make a survey, it would really I think open everybody's eyes.

Mr. DREIER. We would all be curious to know the outcome of that here certainly.

Thank you very much, Mr. Chairman. I appreciate the chance to add a bipartisan spirit to the hearing. [Laughter.]

Mr. NOWAK. Well, that's how the SBA program works. Without the support of our friends on the Republican side and their knowledge of this program, and in many instances their initiatives, we would not be able to hold this very important program together.

As we look at Mr. Dreier's last question about the jobs created, I think you are absolutely right, and one of the things we are going to try to do is encourage the SBA to try to develop some of that data. I think it is going to be very revealing, especially in terms of our competition with other nations. The kinds of products and services that are coming into this country that are subsidized, and

heavily subsidized through different export policies various countries of the world have in this so-called deregulated world economy, may have a bigger and bigger impact. I think this is one program that has a very beneficial effect on keeping competitive, and some of those risks that you take with it are more than justified when you look at the types of revenues that are going to flow in.

On the other hand, we should look at the types of revenues that the Government has to pay out in terms of the so-called safety net programs. I think there is no question that many programs, and this program in particular, is at least a very small and partial offset. It does work within the interface framework very well because it provides opportunities for competition. I am sure when many of these loans are made, it is because of the individual initiative of the borrower, and you can see that his whole life goes into his small business venture because he is that concerned.

Mr. EASTERLY. I would like to make one more comment, Mr. Chairman, if I might.

Mr. NOWAK. Surely.

Mr. EASTERLY. I have been working on a task force in Louisiana for 10 years. We know that our economy is changing. We are trying to get high-tech down there whatever that means. We are trying to work with the people who have an idea to find some way to incubate that idea and bring it up to where he is eligible for SBA loan to get his idea going. These are new inventions and everything else. That is a field, too, that maybe you are familiar with and can give some thought to because there is a big need in that area, and there are beautiful ideas. Everybody looks, but they haven't bought it. You don't really know until somebody has spent some time, effort, and money bringing this idea out to determine if there is a market there and whether it can be marketed.

Mr. NOWAK. I thank you for your testimony. We are going to keep the record open to perhaps fill in some voids as we develop a total record for the rest of the Congress.

I want to thank you very much for attending. We have a vote on the House floor, and when we come back, we will have the rest of the witnesses come up in a group as they have a similar kind of story to tell, so we can move all of the testimony forward. We will adjourn for 15 minutes.

[A short recess was taken.]

Mr. NOWAK. The subcommittee will come to order and we will continue our testimony. What I would like to do is bring to the table as a group, because of the common interest here, the next three witnesses. We will have a panel discussion so that questions can be asked and responses elicited from all three. We will perhaps have a better rounded discussion.

The first member of the panel would be from the Merrill Lynch Mortgage Capital, Inc. We have Gordon R. Watson. Mr. Watson, will you come forward. He is the executive vice president of Merrill Lynch Mortgage Capital, Inc., of New York, and has been with Merrill Lynch for 13 years. He has been involved with the SBA secondary market activities for the past 8 years. He is formerly a two-term chairman of the Government Guaranteed Loan Dealers Association and is currently chairman of the SBA Committee on Capi-

tal Access which was founded by the SBA, and we welcome Mr. Watson.

Our next panel member will be from Morgan, Keegan & Co., Inc. Gary M. Grear, is the senior vice president. If you will come forward, Mr. Grear, we will have you as a member of this panel. Morgan, Keegan & Co. is a regional broker dealer located in Memphis, Tenn. Mr. Grear is also a member of the board of directors of the firm, and is past chairman of the Government Guaranteed Loan Dealers Association. He is a member of the SBA Small Business Committee on Capital Access.

Also the third member of the panel will be from Alex Brown & Sons in Baltimore, Md., Mr. Bob Martin. He will come forward. He is a Government securities and money market specialist. He is a graduate from the Naval Academy and retired from active duty in 1978, and he has graduate degrees in financial management and international affairs.

Gentlemen, we welcome you, and we will again incorporate your testimony in total into the record, and we will proceed with Mr. Gordon R. Watson from Merrill Lynch.

[Mr. Watson's prepared statement follows:]

PREPARED STATEMENT OF GORDON R. WATSON, EXECUTIVE VICE PRESIDENT, MERRILL LYNCH MORTGAGE CAPITAL, INC.

My name is Gordon Watson. As Executive Vice-President of Merrill Lynch Mortgage Capital, Inc., I am pleased to appear before this subcommittee to testify on Merrill Lynch's role in the secondary market for Small Business Administration (SBA) loans and to make recommendations on what the SBA and Congress should do to improve the efficiency of this market.

Merrill Lynch's interest in the SBA secondary market goes back approximately eight years to when I formed the Federal Financing Department. Subsequent to the formation of this department, I served a two year term as the first chairman of the Government Guaranteed Loan Dealers Association which was subsequently merged into the Public Securities Association. I also have had the pleasure of serving as a member of the Small Business Committee on Capital Access.

Merrill Lynch, through our Federal Financing Group in New York, is one of the most active dealers involved in the secondary market for SBA guaranteed loans. Our department in New York and our network of Account Executive specialists throughout the country are actively involved with each step in SBA guaranteed loan transactions. We have the capabilities to assist clients in assembling loan applications, provide interpretation of all aspects of SBA regulations, assist lenders in the structuring of their loans in order to optimize marketability, underwrite the guaranteed portion of the loans, maintain secondary markets in these loans, and frequently introduce lenders to potential borrowers.

Merrill Lynch underwrites the guaranteed portion of the SBA loans, temporarily taking title to these loans and tries to make a profit on these loans by reselling them to investors at a markup. In reselling the loans we have underwritten we assign without recourse all of our right, title, and interest to the purchasing investor.

Merrill Lynch participates in the secondary market for SBA loans in order to better serve the needs of our various customer bases. The lender benefits from the close cooperation of the Federal Financing Group's specialists who perform the various functions associated with the different phases of the secondary market. By selling SBA loans we assist lenders in obtaining the following advantages:

Greater liquidity. In times when funds are difficult or expensive to obtain, particularly for small banks, use of the secondary market gives a bank access to a ready and relatively inexpensive source of funds.

Greater profitability. The sale of the guaranteed portion of an SBA loan can increase the effective yield to a lender thereby increasing his incentive to expand this type of lending activity.

Better service to the community. By selling loans a bank generates more money to lend to local business, creating more business opportunities and employment in the community.

As Merrill Lynch has the capability to act as principal not just as broker, we further facilitate secondary market transactions for lenders. We have the capital to finance bids when the lender is ready to settle, whether or not the loan has been sold to an investor.

Through our involvement in the secondary market for SBA loans Merrill Lynch offers investors a broader range of investment alternatives. As a leading dealer in government guaranteed loans we generally have an inventory of SBA loans large enough to satisfy a wide range of investor requirements as to size maturity, and yield. These SBA guaranteed securities, providing regular payments of principal and interest, have particular appeal for investors who want a secure investment, cash flow, and high yield. Yields on SBA loans are usually greater than those obtainable from comparable U.S. Treasury securities.

Merrill Lynch supports the development and improvement of secondary market operations as this would attract much greater involvement in SBA lending from major financial service institutions and result in more funds at a lower cost available through SBA loans to small business borrowers. We thus offer the recommendations below. We have chosen in part to reemphasize several of the recommendations made by the Small Business Committee on Capital Access in their report dated October 12, 1982 and will not go into detail on these as we assume you are familiar with this report. Any recommendations we make are geared towards the ultimate goal of providing definable benefits for small business.

Existing programs should be streamlined to enhance the efficiency of secondary market operations and to reduce the cost they currently impose on borrowers as well as lenders and the SBA. Maximum interest rates on SBA loans should be eliminated. They are counterproductive. Setting long term interest rates off short term indicators, as now occurs, does not reflect correct interest rate levels. An inverted yield curve will set an unacceptably high peg rate for the borrower and give the lender the potential of charging an excessive interest rate and a resulting substantial service fee in case of resale of the SBA loan in the secondary market. A sharply positive yield curve will peg the rate below long term lending rates and force the lender to sell the loan at a discount in the secondary market; for all practical purposes this greatly reduces the SBA program's effectiveness. In addition, it has been our experience that setting maximum interest rates, in most instances, actually determines the recommended rate to be charged to the borrower which has the potential of increasing the cost of borrowing for the small businessman. Removing interest rate maximums and boosting SBA oversight of lending activities should, in our opinion, lower the overall cost of borrowing.

The loan guarantee processing at SBA district offices should be improved as the inability of these offices to consistently provide timely and professional service in administering requests for loan guarantees is a major impediment to greater lender involvement in the loan guarantee program and ultimately has a negative impact on the development of greater liquidity in the secondary market. The Capital Access Committee Report addressed this issue in suggesting a new preferred lending program which is currently being tested on a pilot program basis by the SBA.

In order to increase the appeal of the secondary market and the ease of using it, certain steps to standardize SBA loans should be taken. The well-known success of the Government National Mortgage Association (GNMA) secondary market is largely attributable to the standardization of the underlying program mechanics. With a more homogeneous product, investor comprehension of and involvement in the secondary market can be boosted significantly. Consequently, we recommend that the SBA do the following:

Mandate the use of a uniform mandatory peg rate on variable rate loans, specifically the "low New York prime rate" as published in the Wall Street Journal or other widely distributed sources of information.

Require lenders to stipulate their methods of accruing interest using either of the two generally accepted methods of calculating interest.

Require the fiscal and transfer agent to remit interest due on a standard accrual calculation allowing the investor of an SBA guaranteed loan to better calculate the anticipated return on the investment.

Problems with timely payment of principal and interest have significantly reduced investor interest in SBA loans. Without a cash flow that can be reasonably estimated, the investor has a hard time analyzing the value of an investment in an SBA loan versus the value of alternative investments. A purchaser of an SBA loan may experience as much as a one month delay in receiving payment. To avoid this

problem we suggest that the SBA require lenders or a fiscal and transfer agent (FTA) to remit principal and interest on a timely basis. If it proved too unwieldy for lenders to remit timely payments, the SBA should consider establishing an escrow fund at an FTA out of which payments could be made. The fund would be secured largely by the SBA's own guarantee. We also suggest that the SBA remit more timely payments in the event of borrower default. At present 120 or more days may elapse between the last payment made by the borrower and the date when remaining principal and accrued interest is refunded to the investor. Overall, reduction in the risk of repayment delays could help reduce the rate of return required by investors and ultimately the borrowing costs faced by small businesses.

In order to facilitate orderly closings of secondary market transactions the SBA must expedite its procedures for approving the sale of loans. Particularly, it should eliminate the time delays attributable to "second looks" at loans presented for approval. These delays discourage lenders and investors from using the secondary market. We recommend that the SBA seriously consider modification or elimination of this step to improve secondary market mechanics and reduce the workload on the SBA district offices. The reduced workload at this level would provide SBA with more resources to provide increased oversight of the program activities.

We endorse the imposition of a ceiling on the servicing fees received by lending institutions which originate loans with the intent of utilizing the secondary market. It is with some reluctance that we approve of a measure that involves further government regulation, however, as mentioned earlier, it is essential that the benefits of a more efficient secondary market be passed on to the borrower. We would gladly endorse any other less structured method that would provide this pass-through of benefits to the primary benefactor of the SBA's activities . . . small business.

It must not be forgotten that a healthy balance between investor needs and required flexibility of borrowers and lenders is necessary in order for a viable secondary market to exist. We, therefore, recommend that the following issues which are critical to investors be addressed: (i) the institution of some form of pre-payment protection, (ii) limitations as to refunding or repurchases of loans by originating lenders, (iii) and the restriction of sales of variable rate loans at excessive premiums by originating lenders.

Finally, in regards to existing SBA operations, Merrill Lynch recommends that the SBA assume greater oversight responsibility in the secondary market as clearly outlined in the recommendation section of the Report to the Congress (April 25, 1983) by the General Accounting Office (GAO). The SBA should develop procedures to clarify and implement its goals and objectives in promoting the secondary market; institute better record keeping procedures; and develop a strategy for using the secondary market to offer small businesses the option of fixed-rate financing.

In addition to the administrative and procedural changes recommended so far, Merrill believes that far reaching innovations are needed to help generate new sources of capital for small business and decrease their effective cost of borrowing. We thus recommend the establishment of a loan pooling and packaging program similar to that of GNMA. The program would combine SBA loans into large, homogeneous packages making it feasible for the nation's largest financial institutions to purchase SBA guaranteed fixed rate loans in quantities appropriate for their size. With more financial institutions active in the origination and purchasing of SBA guaranteed loans, the secondary market would expand, and ultimately the costs borne by the small business borrowers would be reduced. We maintain that loan pooling and the packaging is the single most important step that must be taken to enlarge the secondary market.

We believe the foundation exists for providing substantial support of the small business sector of our economy. Mr. Sanders' personal interest in the development of an effective SBA secondary market has generated the momentum necessary to move forward with a constructive approach. The recommendations made by the Small Business Committee on Capital Access, the GAO, and the testimony today can be the basis for providing efficient access to the capital markets by the small business borrower.

We applaud your interest in this effort and stand ready to provide any support we have available.

TESTIMONY OF GORDON R. WATSON, EXECUTIVE VICE PRESIDENT, MERRILL LYNCH MORTGAGE CAPITAL, INC.

Mr. WATSON. Thank you, Mr. Chairman. I am dispensing with reading my formal testimony. I just have some brief comments to make in order to leave plenty of time for questions.

The subject of the SBA secondary market is one that Merrill Lynch and I personally have been involved in for over 8 years. During those 8 years, I have formed and managed the Federal Financing Department that was responsible for developing an SBA secondary market within Merrill Lynch. I also had the pleasure of serving as first chairman of the Government Guaranteed Loan Dealers Association for 2 years, and most recently I served on the capital access committee which submitted the report to you which is before you.

During the last 8 years, we have seen significant changes in the SBA's secondary market. I believe that the current focus of the SBA and the obvious interest of Congress presents a substantial opportunity to greatly increase the effectiveness of the secondary market and a positive effect on a small businessman's ability to access the capital market.

There are four areas that I want to touch on lightly that I think could be framework for further discussion. The first one is I think it is important that we all keep in front of us what the primary mission is, and to me in our way of thinking, the primary mission of our collective efforts must be to provide the small businessman with greater access to the capital market with terms to meet his needs at interest rates that give him a comparative edge to survive and prosper as a business entity.

Whatever improvements that are made in the secondary market—recommended and are actually made—all have to accrue eventually in one way or another, either directly or indirectly, to the benefit of the small businessman. I think it is very easy sometimes as we are deliberating and talking about these kinds of things to forget again what our primary mission should be, and so I think we have to constantly ask in every one of the issues that are raised either by the capital access report or are raised by GAO or are issues that are discussed here, "How are those issues if implemented benefit directly or indirectly that small businessman that we are trying to identify with?"

Second, the second framework that I think we need to work within is that a strong secondary market—that's a strong secondary market in anything whether it is SBA loans, Ginnie Mae's, used cars, whatever it is. A strong secondary market will evolve only if there is a healthy balance between investor needs and the required flexibility of the borrowers and lenders. There has to be a common ground where everybody gets a degree of benefit or the secondary market breaks down and really does not work properly.

I think as we look again at issues that we might be able to implement the recommended changes, that balance has to constantly come into play. We see this a lot in the mortgage market where I spend a lot of my time in that we have constantly problems in trying to figure out how to securitize the mortgage product because the needs of the investors really weren't identified at the creation

of the asset itself we are trying to sell eventually to the investor, and we have got an opportunity as this thing is developed further—the SBA program I am speaking of—to keep that balance in mind so that we have a proper waiting and can create the type of flow that a secondary market really demands.

The third factor is the key to developing a meaningful secondary market is standardization and creation of an analyzable homogeneous product. The investor must be able to analyze the relative value of this investment to his other options. The investor also must have some degree of assurance as to how the investment will behave in various economic scenarios. The capital access report goes into great detail in recommending steps that will meet this objective. Rather than going back over those issues again, I would like to comment on what I think is the single most important issue in this area, and that single most important issue as far as I am concerned is loan pooling as one of the two basic new concepts that was proposed by the capital access committee, and it really goes back to the origins of the Ginnie Mae market which was alluded to in earlier testimony, and I think, Mr. Chairman, you mentioned it on a couple of occasions.

If you take a look at the evolution of FHA, VA loans going into creating a GNMA security and that evolution over the last 12 to 15 years, there is a striking parallel. It is quite clear that that has become a very, very effective market and has had dramatic impact on the mortgage market.

The same holds true in my belief as far as the SBA loan program and the ability to create a pooling mechanism somewhat analogous or similar to the GNMA program, I think, would have dramatic impact on the whole SBA secondary market.

The fourth thing is I believe that SBA should assume a greater amount of oversight, both as far as lending and secondary market activity. Through various changes, some that have been recommended in the capital access report, some other changes that might come down the road. An increasing number of activities that consume the time of SBA today—mechanical activities can be assumed by the private sector therefore freeing up limited resources to take on a more aggressive oversight role both as far as all aspects of the lending program and the secondary market. I think that was borne out in the GAO report. That's one of the issues that they hit on fairly hard, and I happen to agree with that position.

With that, I think this is the conclusion of my remarks at this time.

Mr. NOWAK. Fine, thank you very much.

Mr. Gary Grear.

TESTIMONY OF GARY M. GREAR, SENIOR VICE PRESIDENT, MORGAN, KEEGAN AND CO., INC.

Mr. GREAR. Thank you, Mr. Chairman, and members of the committee. I appreciate the invitation to come and express my views on a subject that is very dear to me and to our firm.

I am going to speak to some of the things that Gordon mentioned very briefly, and then am going to highlight some of the rather minor problems that the secondary market perceives to exist, but

when you take those and assume them, sometimes they get to be a little more difficult than any one individual problem might appear.

I have been involved in Government-guaranteed finance which is what our firm calls this particular product and the products that relate to it for a little over 7 years. I have been involved in just about every aspect of it as my colleagues have with me, but I guess the overriding factor is the fact that this is probably the most practical solution to the debt financing needs of this Nation's small business.

As Mr. Easterly mentioned, with the issuance of the loan guarantee, a lender is induced into making a loan quite frequently, and because of the secondary market, sometimes the terms that the lenders makes these loans are a little bit more convenient to the borrower.

Probably one of the main aspects of it has been mentioned earlier, or only 20 percent or 25 percent of the SBA guaranteed loans hit the secondary market, but that is really not a good number to look at because, as Mr. Easterly said, it is the fact that this liquidity is available to him that enables him to make these loans in the first place.

For the past several years, I guess the secondary market has not grown. I guess in the last several months it has, but I guess there is one single overriding factor that Gordon mentioned in his comments, and that is the subject of pooling. As I am sure you are aware, in late 1960's and early 1970's, the mortgage people came up with a passthrough concept for GNMA and it has now been improved, and it includes several other agencies. In fact, the passthrough concept is even working in some conventional sectors of the mortgage market.

I think what these mortgage people realize is that there is an enormous source of investment capital out there that if certain improvements can be made to where mortgages or SBA-guaranteed loans or used cars as Gordon mentioned—if there could be a mechanism or allowable thing to do that would securitize these instruments, then the enormous sum of investor capital out there would obviously come into this particular market.

That does a number of things. As most of you know, the broader based a market is, then the more efficient that market performs, and ultimately as Gordon mentioned, the small business person presumably would benefit from a lower cost, a more efficient access to the capital markets that currently only the Nation's largest firms have.

The numbers used to be around $120,000 to $130,000 which was the average size of an SBA-guaranteed loan. When you are dealing with such—I hate to say insignificant because individually $130,000 is quite large, but in the eyes of the financial community, $130,000 or $120,000—that range—is not considered to be a considerable size transaction, so consequently is not going to devote the attention of the larger more sophisticated investors.

I am going to speak very briefly on some lesser difficulties. As I mentioned, collectively, they are a little bit bigger, but I have to commend the Administrator and his people for coming up with a number of ways to accomplish the goals that our capital access committee outlined in its report. I think collectively, if many of

those recommendations can be acted upon, then I think you will see a much larger marketplace with much more liquidity.

I am going to speak very briefly to three problems, and I think one or two of these may have been mentioned earlier, but there is difficulty in standardizing payment calculations when the commercial banking and other private lenders utilize a number of different interest rate accrual methods which currently are in existence and have been for a number of years, and they are all fair, and they all do essentially the same thing, but what that creates for the investor is some difficulty in reconciling those payments, so the investor may not wish to purchase an SBA-guaranteed loan for that very reason.

There is actual over 365, 30 over 360 these are banking terms that any banker would understand, and we clearly recognize that it would be difficult for us—or the SBA—to dictate what method of accrual to use. Consequently, in my discussions with the fiscal and transfer agent, it is my understanding that part of that difficulty could be erased by certain improvements in their ability to process these payments.

Second, payments on SBA-guaranteed loans are not guaranteed to be timely which means that when the borrower makes his payment, the lender will then make his payment, and then if all those payments are made on time then the payment is made on time to the investor. If the payment is late, then obviously the bank is not going to make the payment, so the payment is late to the investor, so there is not a consistency in the income stream to the investor.

In the mortgage markets, that is not the case. As you know, all payments on any convention program or most conventional programs and all of the agency programs, the payments are guaranteed to be timely, so that the investor has a predictable cash flow that he can depend upon.

In the capital access report, there is a solution to this problem, and that is to require the lenders to make the payments whether or not received. I support that initiative. As additional compensation to the lender in this regard, there would be some degree of float time that could be possibly worked out with the lender.

The third minor difficulty is one of a processing nature, and it has been alluded to in Mr. Easterly's comments that the commercial banks sometime think that there is so much paperwork involved in making an SBA loan that they say, "Why bother."

After listening to Mr. Easterly and other lenders, I happen to disagree. I think that the paperwork process is probably as good as it can be. There is one minor thing that could be improved, and that is the elimination of what we call the second look or the look that the agency has to take before the loan gets to the secondary market. Probably what works there is a cursory review to make sure that the loan has been made in conformance with certain rules and then that would be a very quick and not a thorough examination of the loan since the loan was approved. The thorough examination was done at that time.

I would like to conclude with pooling again. There are a lot of things that are involved in the secondary market that are perceived to be critical problems such as payments and so forth that I think would be overlooked if there were a mechanism where the

private sector were allowed to take this heterogenous product and put it together so that you can offer an investor a big piece of paper as opposed to a large number of small pieces of paper.

I appreciate your extending an invitation to me to come and speak and present my views, and I wholeheartedly urge each of you to spend as much time as possible on this particular program because my family has been small business people for a number of years, and I can clearly identify with this program and other things that the Small Business Administration does.

Thank you.

Mr. NOWAK. Thank you very much.

Mr. Martin.

[Mr. Martin's prepared statement follows:]

PREPARED STATEMENT OF ROBERT C. MARTIN, GOVERNMENT SECURITIES AND MONEY MARKET SPECIALIST, ALEX BROWN CO.

Prior to my present association with Alex. Brown & Sons, an investiment banking firm, I managed the investment portfolio for a large credit union in this metropolitan area. Thus, I have been both an investor and a seller of Small Business Administration guaranteed loans. I have been afforded a good insight into the virtues and the pitfalls of buying and selling these loans. While I can readily perceive and appreciate the importance of this program to the borrowers and the lenders in this program, I leave it to others to address the program from that vantage point. My current involvement with the program lies in the secondary market for these loans and the benefits that derive to the purchaser of this investment. Ultimately, of course, this benefits the borrower by replenishing the banker's store of lendable fund and hopefully makes those funds available to the borrower on attractive terms.

As the mortgage and finance industry trends toward a variable interest rate liability structure it increasingly searches for variable rate investment opportunities to match off those deposits. Student Loan Marketing Association notes, Farmers Home Administration guaranteed loans and Small Business Administration guaranteed loans are about the only government agency instruments available offering a variable rate of return. Farmers Home Administration and Small Business Administration guaranteed loans are the only full faith and credit instruments. Depositor concern about being protected against interest rate escalation has prompted many depositories to offer their customers money market accounts and IRAs pegged to some floating rate. Thus variable rate investment opportunities are important to these financial institutions. There are floating rate certificates of deposit which fill this need, but some institutional investors are avoiding CDs in the wake of recent much-publicized bank failures with the attendant investor losses. CDs and corporate floating rate notes are not legal for all investors. The monthly principal and interest payments commonly associated with SBA guaranteed loans offer good cash flow for the investor uncertain about future cash requirements. The choice of maturities available in the marketplace can satisfy most investor interests.

The choice between fixed rate and variable rate SBA guaranteed loans affords an investor the opportunity to hedge against interest rate movements both in a positive and negative direction. The fixed rate loans afford a hedge against declining rates while the variable rate loans hedge against increasing rates. A well balanced portfolio will be hedged both ways.

The superior yields customarily associated with SBA guaranteed loans attracts a class of investor who likes the combination of superior yield and government guarantee. Typical purchasers of these loans include banks, credit unions, savings and loan associations, mutual funds, insurance companies, pension funds and, more recently, municipalities.

The combination of government guarantee and excellent yield provide the original lender enhanced marketability for his SBA portfolio by virtue of the wider investor acceptance.

The program is not, however, perfect. There are several impediments to broad investor acceptance. The problem most frequently encountered relates to the potential for the loans to pay-off prior to maturity. As many of the loans trade at a premium, many investors are reluctant to risk that portion of their investment represented by the premium. Some are disinclined to invest if they are not assured that their funds will continue to earn for them to the full term of the stated maturity. This potential

for prepayment is the feature of SBA guaranteed loans probably most contributory to the higher interest rates associated with them. In order to make the loans attractive to investors at lower yield levels the potential for prepayment must be reduced by improving the overall quality of the loans and by providing the investor with at least some premium protection. Some Farmers Home Administration guaranteed loans entail prepayment penalties. Were SBA guaranteed loans also permitted to include this provision the investor would enjoy some protection against voluntary prepayment by the borrower.

An investor can cushion the impact of early liquidation of his investment by purchasing a portfolio of loans. Thus, even though one or two loans in the portfolio liquidate early, the portfolio can still enjoy a relatively attractive yield. However, the administration and accounting attention associated with a large portfolio of these loans is burdensome. It is much less demanding to build a portfolio of alternative securities. This problem could be alleviated in part if a method of pooling these loans were devised so that a million or more dollars could be invested and a single accounting entry made to account for the purchase and the periodic principal and interest payments when received. Such is the attractiveness of Government National Mortgage Association Pass-Through Certificates as well as those mortgages grouped together into Federal National Mortgage Association Pass-Throughs and Federal Home Loan Mortgage Association Participation Certificates. Pooling of loans has one other very attractive aspect in addition to the reduced administration and accounting burden. This relates to investor concern about loan prepayment. The prepayment of a single loan in a large pool of loans should have minor impact upon the overall performance of the pool. It would be accounted as an extra principal payment much like occurs in a mortgage-backed security. The investment manager would not be exposed to the criticism which is often times experienced when an investment fails and a loss must be booked. Only the more sophisticated and independent investors will purchase more SBA guaranteed loans once they have had to book a loss associated with the prepayment of an individual loan. Pooling could assist in curing that deficiency.

The certification program has improved the physical form of these securities. To the extent that the usage of this program is expanded, the loans will gain wider acceptance. Whatever might be done to encourage more common usage or even to make the certification program mandatory would improve the marketability of the loans.

The inordinate and unpredictable delays involved in delivering SBA guaranteed loans to purchasers detracts from the marketability of the loans. Anything which can be done to expedite the approval and delivery process will improve the acceptability of this product.

Alex. Brown & Sons' role in the functioning of the secondary market has been primarily one of dealing with investors and other dealers as opposed to buying loans from lenders. Early on I sought to develop a direct source of SBA guaranteed loans by calling upon area banks and promoting the virtues of originating SBA guaranteed loans and committing them to the secondary market. I encountered a number of banks which had a single SBA guaranteed loan on the books. The paper work associated with completing that loan and obtaining SBA approval had discouraged them from pursuing more such loans. In instances where I did enjoy some success in encouraging banks to make and market these loans I found my time unreasonably occupied in coaching the lenders through the documentation process. As my firm does not specialize in this product and since I am engaged in selling a wide range of financial products I soon concluded that my time would be more productively spent if I let specialty firms cultivate the lenders and I concentrated on placing the loans with investors. In relation to other product lines I still spend a disproportionate amount of time in examining the loan packages, clearing the trades and following up later on problems. Nonetheless I consider SBA guaranteed loans a valuable part of the total investment package which Alex. Brown & Sons offers.

TESTIMONY OF ROBERT C. MARTIN, GOVERNMENT SECURITIES AND MONEY MARKET SPECIALIST, ALEX BROWN & CO.

Mr. MARTIN. Thank you, Mr. Chairman and Congressman Olin. I, too, will depart from any formal reading of my testimony. I believe that you may have it there. Because some of it is redundant of what you have heard already, I will but highlight a few things and offer a vantage point that may be slightly different from my

colleagues in that we are not as prominent a player in this market as are either of the other two firms represented here today.

We are a regional firm located in this metropolitan area. We have done, I am sure, not nearly so many of these loans as either Morgan Keegan or Merrill Lynch.

Prior to my association with the firm I was the manager of a large credit union investment portfolio, so I do have the experience of having been both an investor in these loans as well as a dealer in them.

I would like to point out that the variable rate SBA loan is one of the unique instruments in our finance world as a Government-guaranteed instrument that bears a variable rate.

There are Sallie Mae variable rate notes and some Farmers Home Administration, but apart from that, the investor community has little opportunity to buy a Government-guaranteed instrument, and only the Farmers Home Administration and the SBA of those three that I mentioned are Government-guaranteed instruments.

That variable rate instrument is becoming increasingly important to a large segment of the financial institution, as they trend more and more toward variable liabilities. IRA accounts, money market accounts, at the banks and the thrifts to some degree can be hedged by those financial institutions' variable rate lendings.

However, to the extent that the loan demand is not present, there is needed an opportunity to lay off those deposits into a variable rate investment. The Small Business Administration loan constitutes one of the limited opportunities for the purchaser who wishes to buy a Government-guaranteed instrument.

There are corporate notes. There are bank CD's. However, recent events with regard to bank failures have caused a little bit of shying away from bank CD's on the part of some investors, and that increases the attractiveness of the Small Business Administration loan to those investors.

That variable rate loan can also be viewed by the investor as an opportunity to hedge against any increase in interest rates. The fixed-rate instruments in his portfolio hedge him against any decline in interest rates. A well-balanced portfolio will be hedged both against increases and the potential for decline in interest rates.

I would agree that the program is not perfect, and I see the single impediment to the broader development of the secondary market to be the potential for these loans to prepay or liquidate prior to maturity. The premium involved will cause many potential investors to shy away from SBA loans because they either do not wish to place at risk any significant premium or they don't wish to invest in something that may liquidate or prepay before maturity, with the attendant concern that they may not enjoy the expected rate of return to the point in time in the future on which they have focused.

To the extent that prepayment penalties could be brought into play to help cushion the impact of prepayment I think it would be good for the secondary market.

Mr. Easterly referred to his bank taking initiative to provide some prepayment penalty or prepayment protection to the inves-

tors where they have directly placed the loans. Farmers Home Administration notes may contain prepayment penalties, and if SBA loans were to also offer the opportunity for that to be incorporated into the note, it would afford a broader market for the loan.

An investor can cushion the impact of early liquidation of some of his investments by purchasing a portfolio of loans. He may buy a $1 million package of loans that might have six or seven loans in it or a larger package with even more loans. Each one of those, however, has to be individually accounted by the investor. He has to take the loans into his books on an individual basis and record the monthly principal and interest payments. It is time consuming, and it is an administrative chore that makes buying multiple loans less attractive than would otherwise be the case.

It does, however, help to cushion him against the impact of the prepayment of any single loan, because the impact of one loan paying off or two loans paying off in a portfolio let's say of 10 loans, does not result in as much of a loss as if he had but a single large investment, so I would endorse the concept of going into the pooling of these loans where it is possible to do so.

I would also suggest to you that there is another reason besides the administrative burden associated with accounting for these loans that makes it commonsense and would increase the attractiveness of the loans.

An investment manager does not like to have to walk in and present to the board of directors, or his boss, or whomever, the fact that he was responsible for influencing an investment which prepaid and which caused the institution a loss by virtue of that prepayment.

If the loans were pooled much like GNMA's as Mr. Grear referred to, there would be received what would amount to an early or a partial prepayment of an individual investment. It would not be so visible, just as the prepayment of a single loan in a GNMA pool is not now so visible.

Since he might own one piece of a very large package of loans, it would not impact upon his investment nearly so much as it does when he owns an entire loan, be it 1 or be it 1 of 10.

The certification program which is the program of converting a sheaf of loan documents into a single piece of paper issued by the fiscal and transfer agent has contributed to the marketability of these loans.

To the extent that is encouraged or even made mandatory, the program would benefit.

My experience probably would support the fact that anything further that might be done insofar as simplifying the total process of documenting the loan package or bringing the loan to the secondary market is worth effort and worth consideration.

Early on in my career with the firm, I called upon many small banks which had a single SBA loan on the books. They recited to me that the task of documenting these loans and the compliance with SBA rules and regulations had discouraged them from ever wanting to try it again. Now, that was several years ago. Improvements have been made, but to the extent further improvements are made, I think the program will benefit.

Thank you very much.

Mr. NOWAK. Thank you. All three, I think, have added another dimension and filled in some of the things that could provide a broader base acceptance of the secondary market.

We looked at pooling to protect the timeliness of a payment, all in furtherance of a more secure instrument we arrive at the end.

You have looked at this from your perspectives as serving on the capital access committee, and I wonder what specifically we could do, what steps we would have to take legislatively. Most of the things that have been mentioned as so-called minor impediments hopefully could be done administratively within the structure that exists out there today, and I wonder if you feel that is true.

Mr. MARTIN. Yes, it does appear to me that for the most part the Small Business Administration is in a position to cure many of the problems and to the extent that authorizations are available that will permit them to fund the program to the extent hopefully in the future that the program should be funded, I would assume that they will proceed to try to implement some of the recommendations that the committee has presented to them.

Mr. GREAR. I think the Administrator and his people are doing some things to begin to help these things along. I guess one of the things that I feel the need to stress is that there are private sector mechanisms that are currently in use in other markets that could be applied to this particular project.

I am not a lawyer, so I don't know whether there is current legislation that would permit some of the things that we wish to do, but the ideas have already been tried and tested and proven to be very good, and they work.

Mr. NOWAK. The comparison has been made, Mr. Watson, with the GNMA's. The whole structure would seem to be in some way very analogous to what we would hope to accomplish. Do you know of anything that has been mentioned here that could not be done administratively?

Mr. WATSON. Actually, it has been my impression that almost all of the recommendations that were made probably could be done administratively. I think there is a concern on the part of the SBA. I have been told that they would like to be able to have the support of a little more legislative authority to do some of these things than they might already have, and there is also a concern, I would guess, as to where OMB's position is on a lot of these things.

Just mentioning the term to OMB that maybe we are creating another GNMA market does not sit terribly well with I believe the current thinking of where OMB is on this issue, but in speaking technically to the point, the only area that seems to me might need legislation is this pooling concept; however, I think there is a possibility mechanically to utilize existing authorities within GNMA and SBA to utilize existing mechanisms to provide that pooling.

Now, I don't know from a practical point of view if agencies can work with each other in that way or not, but the mechanics are there, and I am not positive, but I would believe that close scrutiny of the authority of GNMA would allow them to take in SBA loans and issue certificates against those bigger assets. So even on that score, there is a possibility that specific legislation would not be required.

Mr. MARTIN. Mr. Chairman.

Mr. NOWAK. Yes.

Mr. MARTIN. I have one specific way in which the Congress could help. We have generally accepted the fact that there is a full faith and credit of the Treasury applied to this instrument. However, I have encountered an instance where this was challenged and ruled to be an ineligible investment for a potentially large investor. My liaison with the Small Business Administration suggests that they are interested in clarifying that point, which would necessarily be done through legislation. This would clarify that there is indeed a full faith and credit of the Federal Government applied to Small Business Administration guaranteed loans.

Mr. WATSON. I might add to that. That is becoming more important particularly if you look at the mortgage side of the market. There are so many different types of instruments that are being offered to the investors that are either full-faith and credit obligations or quasi-full-faith and credit obligations, and we are getting various shades of gray. The interpretation of whether it is really full faith or not, is one of the things that the rating agencies are starting to focus on, and a variety of other institutional investors are really starting to grapple with as those markets become very, very large in nature, so clearly to back that statement up, that could become very important to the extent that there is an opportunity to unequivocably clear that point, down the road.

Mr. NOWAK. I think so. When you look at all of the industrial revenue bonds that are out there. The question has come up of what value or what premium is placed on those bonds because they are not backed with anybody's full faith and credit, and I think there is a very real distinction between what is issued there and what is bought by investors. Of course, they are supposedly getting the strength of the company behind that bond, and here it would make a very substantial difference I would think, in our ability to set so-called premium risk if it was very clearly identified.

Mr. Olin.

Mr. OLIN. I don't have too much more, but I did appreciate the kind of testimony that you all gave. I'll ask a couple of questions just to improve my own knowledge of the situation.

First, I take it that your capital access committee has at the request of the SBA made the capital access report. We have made these different recommendations, and that was totally for the benefit of SBA. Do you feel that SBA is in the process of evaluating and will implement your recommendations, or do you have any knowledge of that at all for whomever would like to tackle that one.

Mr. WATSON. Yes.

Mr. OLIN. Mr. Watson.

Mr. WATSON. I think the capital access committee was a super opportunity for the private sector to really have an opportunity to sit face to face with a Government agency and discuss on very business terms a program and probe into how they work and how they could work better and make the various recommendations.

Mr. OLIN. Yes.

Mr. WATSON. It was a very fine experience.

Any time we get involved in things like this or are asked to get involved in things like this, you go into them with a little bit of

cynicism of, "Well, that would be a great exercise, and we might learn something, but that will be the end of it."

In this particular case, I think it has been very refreshing in that not only did Mr. Sanders endorse the idea of letting the private sector really kind of get under the tent a little bit and get involved and make recommendations, but he aggressively took those recommendations, has been very much in support of them, and has become a champion of those recommendations. He really is basing a lot of his position within the agency on those recommendations.

So I think that at least from my personal perspective I think there is movement being made, and the fact that we are sitting here today talking to you leads us further along that line and is equally if not more so encouraging.

Mr. OLIN. Yes. It sounds very good to me, and I think that some good will come of this. The black cloud on the horizon has been however what has been alluded to here. That's the basic attitude of the administration with regard to this kind of activity.

As you are probably well aware, the forward forecast of their recommendations on the authorization for loan guarantees would reduce the loan guarantee annual authorization to considerably less than half what it is currently, and you could reach the conclusion then that the administration is really trying to dry up this activity and bring it to a termination.

I am just wondering that if faced with this forecast which is public, are we in a dilemma here where any actions taken to include the secondary market really won't amount to anything from the point of view that there is a big question of what the long-term life of the program is.

Maybe I should ask Mr. Grear if you could comment on that if you would. Maybe you won't want to. I don't know. [Laughter.]

But that's really the crux of this whole thing. [Laughter.]

Mr. GREAR. I wonder if Mr. Easterly could come up and help me with that. [Laughter.]

Gordon served as chairman of the Government Guaranteed Loan Committee——

Mr. OLIN. Yes.

Mr. GREAR. I was chairman also a year or so after he was, and I had the distinction of being elected at the beginning of the cut, slice, chop, and so the joke was that I was going to be the last chairman of the Guaranteed Loan Committee. I think that is something that we have lived with for the last 2 or 3 years. I think you will find an enormous amount of support out there for these guaranteed loan programs. They are a very cost-efficient way to provide access to the capital market for small and medium sized businesses.

Without going into the details of the benefits, which many have been mentioned——

Mr. OLIN. Yes.

Mr. GREAR. I think you would find an enormous amount of support out there for the programs. Consequently, in my perspective whatever we can do, whatever my firm can do to improve the secondary market mechanism so that it is more efficient and provides a more efficient means for a small businessman to have access to

the capital market, then maybe people will see that there is a major benefit to this program, and maybe it doesn't get cut.

Mr. OLIN. I think that is a very important point. I am personally in sympathy with the desire to take the SBA out of direct loans and to focus on the guaranteed loan program, and I think there is an opportunity here for the private sector, particularly the banks and people like yourself—brokers—to develop a better feeling about the program and feed that back to OMB or whomever it is that is skeptical about the program, feeling that it really isn't doing much good.

The feedback that I bet on this committee is that this activity is extremely important to the development of small business. Of course, Mr. Easterly this morning was recommending that we be much more aggressive with regard to accepting a higher rate of default than we are accepting, and push it harder, which to me makes sense. It is incredible to me that anybody in the Government would reach the conclusion that this was something that is really basically bad or bad policy. Anything you can do to spread the word would strengthen Mr. Sanders' efforts to run this agency properly, and it could possibly remove this big cloud that is over the program.

Mr. Watson.

Mr. WATSON. I just might add that I think in the 8 years that I have been involved in this program, this is not that unusual of a tug of war going on between Congress and OMB in both Democratic and Republican administrations. There seems to be a mindset within OMB that is against what they fear is the proliferation of off-balance-sheet financing of the Government to do away with these types of programs. It seems to me that over the last years, if my mind serves me right, maybe it is a little more intense now, but this has been a problem that has gone through that full 8 or 9 year period.

Mr. OLIN. Yes.

Mr. WATSON. I think it is a reality issue that we have to face, and Congress has to make its will known on these types of issues.

Mr. OLIN. Yes, fine. Thank you very much.

Mr. NOWAK. Thank you, Mr. Olin.

One of the very important points and of course one of the basic reasons for this hearing, was to try to develop the reason for the existence of the program as well as to fine tune this particular aspect of the whole 7(a) program. We are still facing a higher unemployment rate in this country, and we are still looking at tremendous deficits, and of course we know that 1 percent of unemployment equates out to something like $35 billion in added deficit. We would like to find a way to reduce it, and of course, there are many in the House that take the position that we have to have direct funding programs to overcome the unemployment. Many of us have other opinions, and we look at these types of programs as perhaps a better way to invest Federal dollars to let the private sector so to speak give more opportunity for employment through Farmers Home Administration, or the SBA loans, as a more efficient means to expand our employment base and therefore to reduce unemployment, and therefore to reduce deficits, if we have added growth. It is much more preferable than paying out the

kinds of dollars that are needed in the "safety net" programs, and if we could reduce those, we would be doing performing a vast service, I think, toward solving some of these so-called insurmountable problems.

This program along with some of the others has proven, I think, that the investments are very minimal in comparison with some of the overt spending programs that we have been using to balance the so-called inflation versus unemployment.

Mr. OLIN. Would the chairman yield to just one comment——

Mr. NOWAK. Sure.

Mr. OLIN. It occurred to me along the lines that you are talking about and along the lines of my previous statements, that it seems to me that with regard to this guaranteed loan program, we are almost in a position that the administration is really basically trying to squeeze us down to nothing and encourage the private sector to pick up the extra risk. They are really trying to get it down to basic help for the minorities and handicapped and first-time borrowers, but trying to get the private sector to pick up the loan risk involved in financing most of the ventures that are presently coming under the loan program. So either the private sector has got to pick that up and cover that need for the benefit of the economy, or the private sector is going to have to convince OMB and the President and the U.S. Government that it is more appropriate to have this partially financed by the Government through guarantees. Just to sit here doing nothing about it will end up drying up the program and small business will lose the incentive and benefit that it is getting, so I would certainly encourage all of you to work on one aspect or another of it because I think we are in a mode right now that is not going to be good for economic expansion.

Thank you, Mr. Chairman.

Mr. NOWAK. Well, you know, there is going to be pressure in the future to reduce that deficit in some way, but at the same time, you have the counterpressure to expand the Federal impact upon the economy, and you can do it in either way. We can use an overt program which has failed in many instances, at least, to meet the goals of that overt spending, or we can use the Tax Code for added incentives. Now, whether that is more efficient than overt spending is open to question.

Third, we can look at a program like this and say, "This is probably the most efficient way we do it. The private sector has an interest in it. It will stimulate private investment as well as opportunity," and it just seems to me that somewhere along the line in the discussion of the broad industrial policy of the United States, these kinds of incentives will become much more preferable in the mix of incentives to get the economy moving to its optimum.

If we want efficiency, it would seem to me that this is a much better way to go, and we are certainly going to take this record over to OMB and others in the administration to try to prove out that point. Whether we are successful or not in the short term here, I really do think it is going to make more and more sense in the long or in the intermediate term, so to speak, as these deficits stay at these numbers.

You know, we are looking at trying to find a way to reduce the gross overt budget, but we know that the votes we have on the floor conflict in terms of accomplishing that. We can't arrive at a consensus for any large-scale cuts, so hopefully, the growth of the economy will enable us to do that by increasing revenues and reducing the so-called "safety net programs" and the demand for those programs, because everybody will be able to find an opportunity.

Your participation in all of this I think is going to be extremely helpful both for the administration and for the Congress to deal with the fine-tuning of the budget in looking at these individual programs, and I hope that we will have an impact. You have given us some additional individual kinds of incentives to look at, and as you say, most of these can be done administratively. However, we are certainly going to take a hard look at the full faith and credit idea that has been brought out here.

I think the more secure we can make this program, the more sense it will make and start to prove out to be the most efficient way to compete in world markets in the end result.

I want to thank you very, very much for taking the time and the energy to come before this committee, and you may be sure that your testimony will be given a wide view by this committee, not only to the other members but to the administration. Hopefully, we can look forward to working with you again.

Thank you very, very much.

Mr. MARTIN. Thank you.

Mr. WATSON. Thank you.

Mr. NOWAK. The meeting stands adjourned.

[Whereupon, at 12:12 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

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